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Te Awheawhe Tāke

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SUBMISSION TO THE TAX WORKING GROUP

AMP CAPITAL

FUTURE OF TAX

PREPARED BY AMP CAPITAL INVESTORS (NZ) LIMITED

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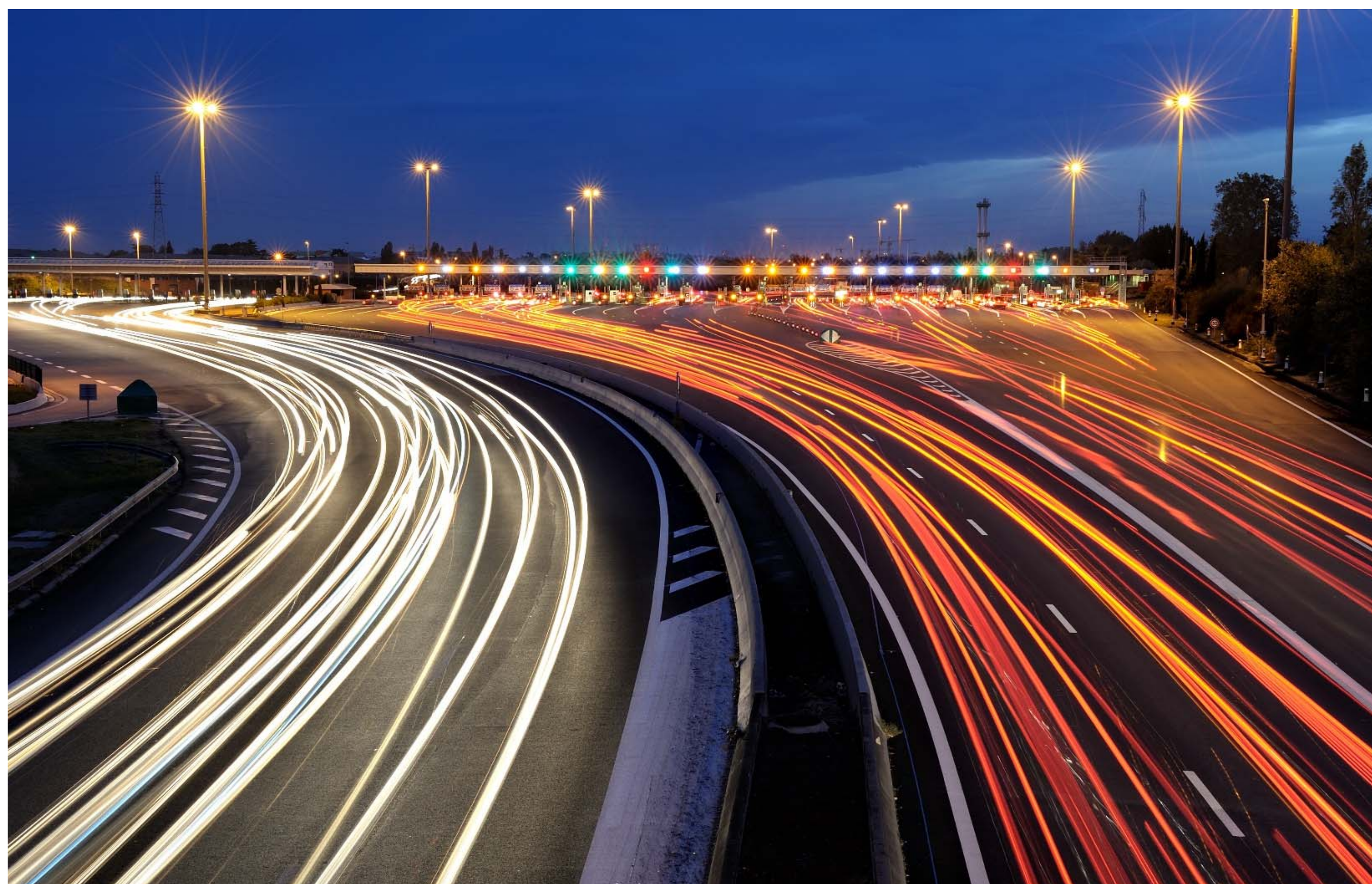

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AMP Capital Investors (New Zealand) Limited

AMP CAPITAL

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AMP CAPITAL

AMP Capital is one of New Zealand's largest investment managers. As part of the AMP group we share a history that dates back to 1849, and today AMP Capital globally manages over A$187 billion (as at 31 December 2017) on behalf of clients through a network of offices in developed and emerging markets around the world.

As a majority owned subsidiary of AMP, we operate independently with a pure investment focus but benefit from the resources of our parent company. AMP Capital has over 70 years' experience managing investments for Australian, New Zealand and international investors. During this time it has evolved from a traditional funds management organisation to a broad-based investment management company, providing services to all sectors of the financial services industry.

In New Zealand AMP Capital has approximately 65 staff and operates in both Auckland and Wellington, with its head office located in Wellington. Our organisation is committed to the New Zealand market and we are proud to provide investment management services to a range of New Zealand entities, including superannuation schemes, corporates, KiwiSaver providers, charities, iwi, insurance providers, life insurers, family trusts, councils, membership and incorporated societies. Currently we have around $21.2 billion funds under management and manage funds on behalf of 100 institutional clients.

INTRODUCTION

- The New Zealand economy has strong macro-economic foundations. We are an easy country to do business with, corruption is low and we have a stable government. However we suffer from relatively low rates of total factor productivity growth which is a constraint on improvements in economic well-being.
- The New Zealand tax system is generally sound and relatively distortion free. One distortion that is a significant constraint on our long-term well-being is the different tax-treatment of property and retirement savings.
- An assessment of the country's future tax needs should not be considered in isolation to the quantity and quality of government spending.
- The New Zealand tax system will be increasingly challenged by globalisation and the free movement of labour and capital. This will necessitate the shift over time to the taxation of less mobile assets.
- Corporate tax rates are in a "race to the bottom" as countries seek to maintain their global competitiveness and attract investment.
- Like many western democracies we are also facing the challenges presented by demographics, particularly our ageing population.

PURPOSES OF TAXATION

- The primary purpose of taxation is to raise the revenue to fund government's activities.
- The tax system is also used to achieve the Government's desired income redistribution outcomes.
- Taxes can be used to discourage certain activities that are determined to be harmful (e.g. tobacco consumption).

ECONOMIC EFFICIENCY AND FAIRNESS

- Tax policy inevitably involves trade-offs between efficiency and equity.
- A tax system designed for maximum economic efficiency may not deliver the desired social outcome with respect to equity and fairness. Equally a tax system designed to maximise fairness and equity will be sub-optimal in terms of maximising economic growth and aggregate national prosperity.
- For example a highly progressive income tax scale may be seen as fairer, while a lower, flatter income tax regime combined with consumption taxes is likely to contribute to higher economic growth.

PRINCIPLES OF A SOUND TAX SYSTEM

- Taxes should be simple, easy and low cost to comply with,
- Taxes should be levied on the beneficiary of the activity being taxed,
- Taxes should be broad-based and low rate,

- Taxes should be stable and predictable to allow businesses and other tax payers to plan for the future,
- The taxes should be raised in a manner that minimises tax-created distortions and economic costs,
- The tax system should not impede global competitiveness.

SPECIFIC COMMENTS AND RECOMMENDATIONS

1 Personal Income Taxes and Goods and Services Tax (GST)

- Efficiency and equity trade-offs are most sensitive in respect to income tax levied on personal income earned and expenditure tax (GST).
- Income tax has an economic cost while GST is regressive and not effective in terms of redistributing income. Therefore reducing the share of tax revenue from income would support productivity and economic growth. Offsetting this with higher GST would be regressive.
- New Zealand has a relatively flat income tax structure (four steps of 10.5%, 17.5%, 30% and 33%) combined with a broad-based goods and services tax of 15%. We believe this structure provides a good balance between efficiency and equity.
- The tax/benefit interface continues to generate high effective marginal tax rates that are a barrier to transition to work and are negative for labour force participation, productivity and economic growth.
- Where there is scope for lower taxes in the future that should be centred on reducing income taxes. Any need for increased revenue should be raised through GST.
- Imposition of GST should remain universal in order to maximise simplicity and minimise compliance costs.
- There are GST boundary issues in particular, around the financial services definitions and the arranging boundary. Falling within or outside these boundaries can create complex issues for taxpayers and create additional costs of GST that cascade for that taxpayer and/or the ultimate end user.
- In particular, the proposed GST treatment of outsourced services obtained by a Fund Manager in comparison to the GST treatment of functions provided by employees of a Fund Manager. The current GST treatment proposal will create an in source bias as no or nil GST applies to salary and wage of employees, whereas GST would be attracted to services provided by third party providers. A review of the GST boundaries and the financial services definition would be appropriate.

2 Corporate Tax

- With respect to corporate taxation, consideration needs to be given to where the tax burden falls. Corporate's pay tax on profits, which means the shareholders are the ultimate taxpayer.
- Corporate tax rates are under downward pressure around the world as countries vie for international competitiveness. New Zealand's corporate tax rate needs to competitive with other counties, Australia in particular.
- When comparing corporate tax rates across different jurisdictions, it needs to be remembered that most jurisdictions do not have imputation or franking systems. This means both the company and shareholder pay tax whereas in New Zealand the shareholders tax is generally offset by imputation credits. When comparing corporate tax rates between jurisdictions both the entities tax and shareholder tax positions should be considered.
- New Zealand's current corporate tax rate of 28% is higher than the G7 average of 21.5%. Australia's corporate tax rate is 27.5% for base rate entities or 30% otherwise.
- A progressive regime for corporate tax:
  - If lower or progressive rates are introduced than consideration of the universal imputation credit system for all corporates needs to be made.
  - Further consideration will need to be given to the double tax issue of the entity/company and the shareholder.
- A key consideration is the need to avoid a significant gap between the corporate tax rate and the top personal tax rate so as not to encourage structuring of individual's tax positions to maximise their tax efficiencies. That gap is already 5 percentage points.
- International pressure to lower the corporate tax rate is constrained by the progressivity of personal income taxes.
- While the gap between the two rates would be costly to close, consideration needs to be given to the cost/benefit of lower the corporate tax rate further if it were to open up a more significant gap.

3 Capital Gains Tax and Housing

- As pressure grows to maintain revenue as the population ages, a broadening of the tax base will be required.
- Introduction of a broad-based capital gains tax is the obvious missing component of our tax system when we compare ourselves with overseas jurisdictions.
- There are arguments for and against a Capital Gains Tax.
- Arguments for include:
  - Prima facie a level playing field or consistency from a tax perspective across all types of assets or investment types e.g. fixed interest securities, equities, real estate etc. assuming there are no or very limited exemptions.
- Arguments against include:
  - Any exemptions or special exclusions from any Capital Gains Tax regime will create an uneven playing field or a fairness issue from a tax perspective.
  - Potential double taxation if other rules or regimes are not removed or changed on the introduction of Capital Gains Tax regime.
  - The cost of foregone revenue due to Capital Gains Tax regimes being on a realisation basis, whereas the Fair Dividend Rate (FDR) income method under the Foreign Investment Fund rules is on an straight five percent of the market value which includes an unrealised portion.
- New Zealand has elements of a Capital Gains Tax (the bright-line test for residential property, the Fair Dividend Rate method under the Foreign Investment Fund rules, and the Financial Arrangement Rules), but the piece-meal approach adds complexity, confusion and avoidance.
- Given that the family home has been excluded from the Group’s Terms of Reference, introduction of a Capital Gains Tax would not meet the criteria of a comprehensive CGT and would open it up to avoidance and non-compliance, the policing of which would more than outweigh the benefits (efficiency gains) of the tax.
- The lack of any tax on the imputed rental value of owner occupied housing continues to contribute to over-investment in housing and under-investment in more productive assets.
- Consideration would need to be given to the implications on or for Portfolio Investment Entities (PIEs) and whether exemptions for this type of entity would be appropriate.

4 Taxation of retirement savings

- A significant distortion in the New Zealand tax system exists between the tax treatment of housing and retirement savings.
- Accepting the non-viability of a broad-based capital gains tax doesn’t preclude the need to level the playing field between property and retirement savings.
- Having ruled out a comprehensive Capital Gains Tax and in the absence of a tax on the imputed rental of owner occupied housing the rebalancing should be achieved through a change to the tax treatment of retirement savings.
- The tax treatment of housing is that home owners buy their home (pay off their mortgage) using after tax income. However neither the imputed rents nor the capital gains are taxed. This equates to a tax-exempt-exempt regime.
- The tax treatment of retirement savings is that contributions are from after tax income, investment earnings are taxed, but withdrawals are tax-exempt. This is described as “TTE”
- A levelling of the playing field would be assisted by the transition to an “EET” for retirement savings. Under an EET regime, contributions are made out of gross income, investment earnings would be tax exempt but withdrawals would be taxed.
- We acknowledge that the transition would be fiscally challenging but such a move would leave the country in a stronger position long term.
- If New Zealand superannuation had an EET approach this would be out of step with Australia, which currently has an TTE approach to its superannuation.
- The ability to transfer superannuation between New Zealand and Australia for individuals could be complex and difficult, if there are different approaches to superannuation.
- There will be tax complexities for a more mobile labour force that works in both New Zealand and Australia if there are different approaches to superannuation between the jurisdictions.
- We would be competing from the same standpoint for investment assets as the European superannuation funds (EET approach).
- We need to create options and/or products that provide the appropriate tax outcomes for individual taxpayers once they exit KiwiSaver or its equivalent under the EET approach.

- We need consistency of tax outcomes for investors when saving via a structure (superannuation scheme) versus investing directly. This could be achieved through:
  - Removing the threshold for individuals before the Foreign Investment Fund rules apply
  - Requiring all tax payers e.g. individuals and companies to apply the same rules to all assets for calculating their income that is the Foreign Investment Fund Fair Dividend Rate method (like PIEs) for offshore equities
  - Removing the revenue/capital issues i.e. are they a trader for individuals investing in equities.
- Consideration needs to be given to the consistency of tax outcomes between the different types of investors. In particular, the tax outcomes for employed individuals, self-employed individuals, charities, children etc. There are inconsistencies such as currently charities are unable to utilise tax credits allocated to them. In the future, they could be compensated for their inability to utilise tax credits such as imputation credits allocated them.
- There should be a consistency of tax outcomes across all types of investments such as shares, fixed income and property/real estate. This would mean:
  - no or very limited exemptions to ensure the fairness criteria is met;
  - the same or similar treatments of deductions or costs e.g. depreciation is claimable on all business asset types and this includes property used for commercial purposes;
  - all of these assets are taxed on the same basis such as a realisation basis; and
  - the same or very similar tax outcomes are reached, no matter the structure or not around the assets.
- The impact of the digital economy on saving for retirement including;
  - more people with less regularity of sources of income e.g. people have 2 or 3 part time jobs that are equivalent of a full time job;
  - they may not be part of the employer deductions process depending on the types of jobs they have so they will fall into the self-employed person's category;
  - it may be appropriate to have some sort of the withholding process that could include a retirement savings contributions for these types of persons.
- More self-employed persons need to be encouraged to contribute towards their retirement savings
  - As they are not regular contributors as given they are removed from the employer deductions process,
  - The regularity or not of their cash flows can cause lumpy contributions,
  - Consideration needs to be made on whether targeted incentives or concessions would encourage these persons to save for their retirement.
- Introduce an ability for the Government to easily introduce concessions to assist retirement savings for targeted parts of the population e.g. self-employed persons,
  - To encourage self-employed persons to contribute more regularly,
  - To assist children and or minors to form savings habits through say applying a lower or zero PIE tax rate to any PIE income they receive.
- To fix some of the current issues encountered around structures such as trusts and unit trusts that are not recognised in all parts of the world, consideration needs to be given to introducing a widely held look-through company that could tax shareholders appropriately like the PIE regime.

5 Land Tax

- Another option for base-broadening is a property or land tax.
- New Zealand had a land tax prior to 1992, but there were considerable exemptions and the tax only affected a small number of taxpayers.
- If a land tax were subject to the same constraints as a capital gains tax i.e. excluding the family home, it would not meet the criteria for a comprehensive tax which would encourage avoidance and undermine the intent of the policy.
- New Zealand already has a form of land tax levied as rates by local and regional government agencies.

6 Other

Non-residents working in New Zealand

- Currently there is an onerous on New Zealand taxpayers and employers to deduct and return the appropriate amounts of tax or withholdings when employing or utilising non-resident persons.
- Increasingly it appears that labour will continue to be more mobile which results in more compliance obligations, which will be increasing more complex for New Zealand taxpayers to administer.
- As a whole Government knows more about non-resident persons than those New Zealand entities paying them.
- Consideration should be given to introducing a regime where deductions from income or revenue earned whist in New Zealand is administered in the future by the Government through:
  - Immigration identifying non-resident person's entering New Zealand and passing on data to Inland Revenue,
  - Inland Revenue dealing directly with the non-resident persons on the collection of the appropriate deductions i.e. taxes, PAYE, withholdings, levies etc. from the income or revenue they earn whilst in New Zealand,
  - As part of the process of collecting the deductions Inland Revenue could direct New Zealand taxpayers to deduct specific taxes from amounts paid on a timely basis,
  - Before or on leaving New Zealand the non-resident person is required to obtain a digital clearance from Inland Revenue in regards to their tax position including any payment of taxes etc.
- Business/taxpayers providing data and information once to Government
  - Taxpayers are often providing the same of similar data and/or information to different parts of Government including Inland Revenue.
  - The Government as a whole (departments, regulators, semi or full enterprises) need to understand what information and data they have and share it, as appropriate.
  - This would result in taxpayers providing data and/or information only once.
  - For taxpayers this would reduce complexities and costs as the provision and storage of information and data is expensive.

COMPLEXITIES

AMP Capital is aware that our suggested focus areas and recommendations include some difficulties that would need to be resolved, these are:

Transition issues

- On changing approaches for retirement savings, consideration needs to be given to
  - The Period over which transitioned from an TTE to an EET approach
  - Education of those affected by the changes and in particular what it means to them from a tax perspective by all parties but in particular the appropriate part of Government. In particular, why one approach means no tax liability arises when they make withdrawals whereas the other approach gives rise to a tax liability on withdrawals,
  - As part introducing changes to the approach introduce a vehicle or structure that is recognised offshore. This would remove comprehensive issues and to allow access to New Zealand managed funds under the Asian passport.
  - There will be complexities in running two different models i.e. PIE under TTE and the new approach vehicle under EET.
  - Costs involved including conversion costs incurred in transitioning to a new model, if possible and running both the old and new approaches structures, at the same time.
  - On introducing new tax regimes such as capital gains tax and land tax,
  - The valuation of all assets when the regime is introduced including the rules and processes required around this.
  - The total costs incurred by all, through introducing new tax regimes including for Inland Revenue and all taxpayers. In particular, systems builds and ongoing compliance costs.
  - Determining exemptions, exclusions, special or specific rules e.g. excluding PIEs from capital gains tax on the investments they manage.
  - The effect on other current rules e.g. Capital Gains Tax impacts on Foreign Investment Fund rules and PIE exemption on capital gains on NZ and Australian shares.
  - Potential double taxation in particular under the application of the current Financial Arrangement and Foreign Investment Fund (FDR - Fair Dividend Rate) rules which tax capital amounts and any Capital Gains Tax regime.

Thresholds

- The tax impact of changing a threshold level under a progressive tax system, can have a significant economic influence.
- There are behaviours that can occur around trying to ensure that a certain threshold level is met or continues to be met under a progressive tax system.

Long-term Stability

- There needs a stable platform of regulatory and tax rules e.g. infrastructure investments are generally held over 25 or more years, thus tax changes impact the returns which are modelled over the life of the investment and the applicable rules prior to investment being made.

CONTACT US

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