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Te Awheawhe Tāke

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Submission to the Taxation Working Group

KiwiSaver and tax: a commentary on aspects of the TWG's interim report: *The Future of Tax*

- **Where is the evidence?**

[1]

Michael Chamberlain

[1]

Michael Littlewood

23 October 2018

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Abstract

The Tax Working Group's recommendations on the tax treatment of KiwiSaver are not evidence-led. We have no real idea whether KiwiSaver is 'working' because we do not know what impact KiwiSaver is having on a household's other financial assets. The current (2019/20) cost of KiwiSaver tax breaks ($840 million) will, the TWG estimates, increase to $1.05 billion. It is likely that the current tax expenditure is wasted. The extra $215 million will also be wasted because, before KiwiSaver, New Zealanders were, on average, probably saving enough for retirement, as the TWG itself acknowledges.

New Zealand needs a first-principles, evidence-based look at the tax treatment of all 'collective investment vehicles' of the kind that New Zealanders might use for retirement saving. The TWG's report does not do that. Favouring KiwiSaver alone distorts the tax playing field for no explained reason. Such a proper review will likely also undermine the TWG's interest in a full Capital Gains Tax and should provoke significant changes to the 'Fair Dividend Return' or FDR approach for calculating taxable income. The FDR regime should be either abolished or extended to local investments to remove a current major distortion in the tax playing field.

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He was a member of the New Zealand government's 1991-92 Task Force on Private Provision for Retirement and is the author of *How to create a competitive market in pensions – the international lessons* (IEA, London 1998).

Michael retired as co-director of the RPRC in June 2015.

The submitters were co-authors of:

- *Towards a more rational tax treatment of collective investment vehicles and their* investors (2010), Working Paper for the Retirement Policy and Research Centre accessible here.
- *The Missing 2016 Review – building trust for life beyond work* (2017); posted online at www.alt-review.com

1. The purpose of tax incentives for retirement saving

1.1 The Tax Working Group (TWG) issued its report *Future of Tax – Interim Report* (TWG report) on 20 September 2018.

1.2 After stating what the TWG describes as 'goals and interests' with respect to retirement saving, paragraph 7.5 of the TWG report then states:

> "There is some evidence to suggest that most New Zealanders are saving enough to provide an 'adequate' income in retirement. However, this judgement is conditional on the assumption that future generations remain eligible for New Zealand Superannuation under existing policy settings. This condition may not hold if long-term fiscal pressures require change to the scheme. Falling rates of homeownership will also affect the adequacy of savings for retirement." TWG report, page 46

1.3 We think this is probably the first occasion we have ever seen any official acknowledgement (unattributed in the TWG's report) to work done by a number of researchers in the last 15 years on what New Zealanders are actually doing about their retirement saving needs.

1.4 There are three key statements in the quote that we will analyse separately:

- "…most New Zealanders are saving enough to provide an 'adequate' income in retirement."
- "…conditional on the assumption that future generations remain eligible for New Zealand Superannuation under existing policy settings."
- "Falling rates of homeownership may also affect the adequacy of savings for retirement."

1.5 To be complete, the TWG report actually says "There is <u>some evidence</u> that New Zealanders are saving enough…" (our emphasis). It might be more accurate, but perhaps less helpful for what follows in the TWG report, to turn the statement around and say there is no evidence that New Zealanders, as a whole, are under-saving for retirement.

1.6 With that introduction, the TWG then offers its recommendations:

- Remove 'employer superannuation contribution tax' on the 3% mandatory contributions to KiwiSaver for employees' earning up to $48,000 a year;
- A five-percentage point reduction for each of the lower PIE rates but only for savings in KiwiSaver;
- Simplify the way PIE rates are applied for KiwiSaver members.

TWG report, page 54

1.7 So what exactly is the case for directly subsidising returns to KiwiSaver contributions by raising the taxes paid by other taxpayers, including non-KiwiSaver members? How can the TWG report move from acknowledging that New Zealanders are saving enough to helping them to save more, but only in a particular way? How can the TWG justify the suggested tax changes in the face of a desired objective not to distort capital markets?

1.8 We will shortly analyse the three 'conditions' that the TWG uses to qualify its 'saving enough' statement. But first, we will offer the evidence that seemingly led the TWG to make that statement (or should have).

2. Retirement saving – the evidence

2.1 Our report *The Missing 2016 Review – building trust for life beyond work* (2017)[1] laid out everything that we currently know about New Zealanders' retirement saving habits. Section 14 of our report here gives links to all the relevant reports. For completeness, we repeat them here[2]:

- New Zealanders were probably slightly over-saving for retirement before KiwiSaver started in 2007 (Treasury reports from 2004[3], March 2007[4] and from 2009[5]);
- Of KiwiSaver contributions, about one-third was 'new' savings, the rest being effectively transferred from other financial assets (Treasury report 2011[6]);
- KiwiSaver members seemed to have accumulated less net wealth than non-members (Treasury report 2014[7]);
- Poverty levels amongst the over-65s are the lowest of any of the groups in New Zealand society (MSD reports from 2007 to 2013[8]) and are among the lowest of over-65s in any country (OECD 2008[9]) and also by comparison with 27 EU and other European countries (2009)[10];
- The overall cost to taxpayers of retirement income policies (public and private) is amongst the lowest in the developed world (OECD 2015[11]);

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[1] The full report is posted online (and by section) at www.alt-review.com.

[2] The summary and links were also included in Michael Littlewood's submission to the TWG of 30 April 2018, accessible here so presumably they helped the TWG to make its 'saving enough' statement.

[3] *Saving for Retirement: New Evidence for New Zealand*, Grant Scobie, John Gibson and Trinh Le, New Zealand Treasury, 2004, accessible here.

[4] *Are Kiwis saving enough for retirement? Preliminary evidence from SoFIE*, Grant Scobie and John Gibson, New Zealand Treasury, March 2007, accessible here.

[5] *Saving Rates of New Zealanders: A Net Wealth Approach*, Grant Scobie and Katherine Henderson, New Zealand Treasury, 2009, (accessible here).

[6] *KiwiSaver: An Initial Evaluation of the Impact on Retirement Saving*, David Law, Lisa Meehan and Grant Scobie, New Zealand Treasury (2011) accessible here. Care though has to be taken with SoFIE data as participants' recall of basic information seems at variance with IRD data – see *KiwiSaver: Comparing Survey and Administrative Data*, Anton Samoilenka and David Law, New Zealand Treasury (2014) accessible here.

[7] *KiwiSaver and the Accumulation of Net Wealth*, David Law and Grant Scobie, New Zealand Treasury (2014) accessible here.

[8] See *Household Incomes in New Zealand - Trends in Indicators of Inequality and Hardship 1982 to 2004* (2007), Bryan Perry, Ministry of Social Development (accessible here). By 2008, however, the income-based measure had worsened from 7% in 2004 to 14% (see *Household Incomes in New Zealand - trends in indicators of inequality and hardship 1982 to 2008* (2009), Bryan Perry, Ministry of Social Development (accessible here). By 2012, the position had improved again: to 6% of all over age 65 in "low income households" – see *Household Incomes in New Zealand - trends in indicators of inequality and hardship 1982 to 2012* (2013) Bryan Perry, Ministry of Social Development (accessible here). That volatility illustrates the close relationship between the 60% of income 'poverty' measure and the annual amount of New Zealand Superannuation; also that many old people have little private income. We should expect less volatility in deprivation-based measures of poverty.

[9] *Growing Unequal? Income Distribution and Poverty in OECD Countries*, OECD (2008). New Zealand was one of the three countries that show an overall incidence of poverty in the "mid 2000s" amongst all people "of retirement age" of about 2% (rounded up from 1.53% in New Zealand's case). The other two countries were the Czech Republic and the Netherlands. The report itself is not accessible online but was looked at in the RPRC's *PensionBriefing, 2009-1, International comparison of poverty amongst the elderly* – accessible here.

[10] See *The material wellbeing of New Zealand households: trends and relativities using non-income measures, with international comparisons*, Bryan Perry (Ministry of Social Development) 2016, accessible here, at page 19.

[11] *Pensions at a Glance 2015*, OECD (accessible here) at page 181. Of 34 OECD countries, the net cost of NZS is 7th lowest. However, that ignores compulsory 'private' schemes and also the cost of tax breaks for private provision. Australia, for example, spends about two-thirds as much on tax breaks for retirement saving as it does on the Age Pension itself (*2016 Tax Expenditures Statement*, Australian Government, accessible here).

- A StatsNZ survey in 2014 found that 71% of over-65s reported having "enough or more than enough money" and 86% reported having "high life satisfaction (7-10 on 11-point scale)"[12].

2.2 The TWG report offered no evidence to even raise a doubt about the findings in the reports referred to in paragraph 2.1. So, we suggest that not only is there "some evidence" that "most New Zealanders are saving enough to provide an 'adequate' income in retirement", as the TWG report states but also that there is <u>no evidence</u> of New Zealanders' generally under-saving for retirement.

2.3 Submissions:

2.3.1 We make the following three observations on this fundamental issue:

1. Based on all the evidence we have, there are no grounds for the government to intervene in the decisions that individuals make on:

- **Whether to save for retirement;**
- **When to save for retirement or**
- **How to save for retirement.**

If we are right that the TWG's own three qualifications to the 'saving enough' statement are insufficient grounds to set aside the evidence detailed above (more on this in sections 3-5 below), what other evidence does the TWG have to justify its proposed tax-driven interventions?

2. Far from reducing tax on, particularly KiwiSaver schemes, we strongly urge the TWG to focus its attention on levelling the tax playing field so that, in the words of the Inland Revenue's 2005 Consultative Document:

> *"…it is important that the tax rules for investment income operate efficiently and that investors' decisions are not distorted by different tax treatments for income from investments that are similar in nature……*
>
> *"The proposals outlined in this discussion document aim to resolve these inconsistencies and the distorting effect they have on investor decision-making."*[13]

We have more to say on this in section 6 below.

3. We urge the TWG to put each of its recommendations with respect to KiwiSaver through a basic test:

> **"Will this recommendation, if implemented, distort a saver's decision, whether to use KiwiSaver rather than another investment that is 'similar in nature'?"**

If the answer to that is 'yes' (as will assuredly be the case) what is the TWG's rationale for preferring KiwiSaver over other investment arrangements that are 'similar in nature'?

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[12] *New Zealand General Social Survey, Statistics New Zealand (2014)* accessible <u>here</u>.

[13] *Taxation of investment income - The treatment of collective investment vehicles and offshore portfolio investments in shares* (2005) Inland Revenue Department, accessible <u>here</u>.

3. The future of New Zealand Superannuation – the evidence

3.1 The TWG report questioned the robustness of the 'saving enough' evidence summarised in section 2 above by saying it was "…conditional on the assumption that future generations remain eligible for New Zealand Superannuation under existing policy settings."

3.2 Given that the reports cited above were founded on a 'total retirement income' concept (public + private) then it follows the findings of retirement saving adequacy are dependent on a continuation of New Zealand Superannuation (NZS) in something like its current form[14].

3.3 So, if it were possible to show that the current benefit structure of NZS was sustainable into the future then that particular doubt on the 'saving enough' statement would presumably be resolved.

3.4 In our 2017 report, *The Missing 2016 Review*, we analysed the evidence on:

- The likely future costs of NZS – see section 4 of our report here;
- Whether NZS in its current format was unsustainable – see section 5 of our report here.

3.5 We acknowledged that it would be a good time to review every part of the benefit design of NZS (see section 6 of our report here) and, importantly, that review was not driven by a concern about the sustainability of NZS as it is. Rather, the review is needed because NZS had developed haphazardly over the last 40+ years and it was now time to undertake an evidence-led discussion about all 13 benefit design features of the most expensive single item of government expenditure.

3.6 In summary, we concluded that, based on the Treasury's regular estimates of the net cost of NZS stretching out over the next 40+ years and based on today's experience of other OECD countries, NZS in its current form is sustainable and did not have to change on that ground alone.

3.7 As a marker of our confidence, the latest (2018) Treasury estimates suggest that NZS will cost taxpayers of 2060 a net 6.7% of GDP, compared with a net 4.0% today[15]. By comparison, OECD countries were paying an average net 7.3% of GDP for public pensions in 2011[16].

3.8 Submissions

3.8.1 The TWG's 'saving enough' statement was, among other things, "…conditional on the assumption that future generations remain eligible for New Zealand Superannuation under existing policy settings."

[14] The findings of the 'saving enough' reports were also based first, on New Zealanders' continuing to do what they were doing; next on savings earning a net real rate of return; thirdly on everyone who reaches retirement sopping work at age 65 and having post-retirement spending that is equal to their pre-retirement standard of living with that continuing until their death and lastly on the assumption that the family home passed intact to the next generation. Taken together, these were fairly conservative assumptions.

[15] These latest estimates are from the Treasury's 'nzsf-model-BEFU', 2018 and showed a 6% reduction in estimated 2060 costs from the *2016 Statement on the Long-term Fiscal Position* of 7.1%

[16] *Pensions at a Glance 2015, OECD and G20 Indicators* at page 179.

3.8.2 While today's government cannot bind future governments to 'no future change', we submit there is no evidence to suggest that future generations of superannuitants need receive any less than today's. We therefore suggest that condition 2 of the TWG's 'saving enough' statement is satisfied.

3.8.3 If the TWG disagrees with this conclusion, we must assume it has other evidence that undermines the future sustainability of NZS. The TWG should produce that evidence and work with Treasury to help it improve its model and assumption basis.

3.8.4 The possibility that a future government might change NZS is, of itself, no justification to change other public policy aspects of New Zealand's retirement income framework today. As a country, we must however acknowledge future uncertainty and that justifies the exploration of issues associated with possible changes to the size and shape of NZS.

4. Are home-ownership rates actually falling? – The evidence

4.1 The TWG report also questioned the robustness of the 'saving enough' evidence summarised in section 2 above by saying that "Falling rates of homeownership may also affect the adequacy of savings for retirement."

4.2 One key condition of the 'saving enough' reports cited in section 2 above was that New Zealanders kept doing the things they were already doing in the 2000s. One of those was that most New Zealanders reached age 65 with a debt-free home or, alternatively, sufficient income to pay rent.

4.3 So, we agree that long-term home-ownership patterns are an important part of the 'saving enough' framework.

4.4 The TWG's 'saving enough' statement assumes falling home-ownership rates as though that was an evidence-based fact.

4.5 In our report *The Missing 2016 Review*, we summarised what is currently known about this contentious issue – see section 12 here.

4.6 Census-data over the past 30 years have shown a seeming decline in home-ownership since an apparent peak in 1991. However, those 'headline' numbers disguise a disturbing trend in response rates to questions about the tenure of dwellings on Census night.

4.7 There are too many gaps in the questions asked in the 2013 Census (and earlier equivalent questions) for us to be certain about any recent trends in home-ownership rates. The gaps mean that, in 2013, we have no ownership information for about 362,000 of all dwellings; that's 20.7% of all 1.76 million dwellings.

4.8 There are two main holes in the data. First, we have no information about who owns the 185,448 dwellings that were unoccupied on Census night in 2013 (10.6% of all dwellings). Neither do we know why they were unoccupied. They might be holiday homes, between tenants, on the market, under renovation or the usual occupiers (owners or renters) may have been away on holiday or business. We just don't know and that affects our understanding of the owner/occupier status for more than one tenth of all dwellings in 2013.

4.9 The other major hole is the occupiers who didn't answer the question or who gave an unclear answer. That was another 176,835 dwellings or 10.1% of all dwellings in 2013.

4.10 These two major data gaps have been growing in total since the 1986 Census – the total 2013 gap (20.7%) was 19.4% in 2006. Part of that is probably caused by the rise in family trust ownerships, though the Census questions tried to capture these. Gaps in the questions also contributed.

4.11 Based on what we saw of the questions in the 2018 Census, we expect that these data gaps will be somewhat larger than in 2013 (and earlier Censuses).

4.12 An alternative rental-based measure (the alternative to 'ownership') suggests that there has been no significant change to ownership patterns in recent decades. Rent-payers, who have to specify the amount they pay in rent, have been less than 30% of all occupied dwellings since 1956 (simple average of the 12 censuses was 25.3%). In 2013, it was slightly higher than the 57 year average at 29.2%. But that implies the other 70.8% of occupied dwellings had some type of ownership connection with the dwelling in 2013.

4.13 None of this is good enough. No-one really knows whether home-ownership rates are currently falling and, in the context of New Zealanders' financial preparation for retirement, we need better information. We cannot even start a discussion about issues that are affected by home-ownership rates without answers to some fairly basic questions.

4.14 Submission

4.14.1 It is simply not possible to state with certainty that home-ownership rates are falling. Any recommendations the TWG makes on that premise need to be heavily qualified. So, without better data, no-one can say whether the TWG's condition #3 on the 'saving enough' statement raises sufficient of a red flag about New Zealanders' saving behaviour that state intervention is needed. Therefore, no one can conclude that the proposed tax changes improve fairness.

4.14.2 We do, however, recommend that the TWG qualifies its presumption about 'falling home ownership' and urges the government to find out what is really happening on this. We need that information for other public policy reasons, not just about financial preparation for retirement and tax reasons. What information we have is just not good enough.

5. Do tax incentives increase retirement saving? The evidence

5.1 So far, we have established that the three conditions made to the TWG's 'saving enough' statement on page 46 of its report seem not to undermine the overall 'saving enough' thesis. Specifically:

- There is no evidence that New Zealanders are under-saving for retirement;
- NZS seems to be sustainable over the next 40 years or so, without the need to change its benefit structure for this reason;
- Home-ownership rates may be changing but the only evidence we have on this is, to say the least, 'difficult'.

5.2 The TWG report then makes a logical leap – despite the evidence we have cited and its original proposition, the only three options the TWG recommends to 'fix' an otherwise unidentified 'problem' are three additional tax-based initiatives for retirement saving, but only if that is done through KiwiSaver. Even locked-in workplace savings schemes do not have the opportunity to qualify for the new concessions.

5.3 For the next part of our analysis, we have to assume for a moment that there is a 'problem' to 'fix' (under-saving for retirement). The question we want to consider now is whether tax breaks specifically for retirement saving actually increase retirement saving. What is the evidence on this question?

5.4 The TWG report assumes that the current tax breaks for KiwiSaver are working. We concede that any evidence on this is not as clear as we would prefer. However, what we have (as mentioned in section 2 above) suggests a less-than-resounding 'success':

- Of KiwiSaver contributions, about one-third was 'new' savings, the rest being effectively transferred from other financial assets (Treasury report 2011);
- KiwiSaver members seemed to have accumulated less net wealth than non-members (Treasury report 2014);
- After 11 years, the average KiwiSaver balance is just $17,130[17].

5.5 In addition, KiwiSaver is likely to increase post-retirement inequality, introduce new inequalities, shift savings from less-favoured saving vehicles and, together, reduce the re-distributional effect of NZS itself[18].

5.6 However, as described in our 2017 report *The Missing 2016 Review*, it isn't possible to measure the impact of an initiative like KiwiSaver, nor even the utility of tax incentives on either KiwiSaver itself or, more importantly, on overall saving behaviour without a longitudinal household financial survey[19]. Without that evidence, we simply do not know whether anything needs 'fixing' nor whether any suggested initiatives, such as those suggested in the TWG report, might help, or make things worse.

[17] *KiwiSaver Annual Report 2018*, Financial Markets Authority accessible here.

[18] *The Distributional Impact of KiwiSaver Incentives* (2008) by Chris Hector, John Gibson and Trinh Le accessible here. To be fair, this report was published when the amounts of the then new tax incentives were at their peak. However, any savings scheme that is linked so closely to work and pay, such as KiwiSaver, will of itself have those effects. The tax incentives exacerbate those tendencies.

[19] Section 15 of our 2017 report here described the somewhat limited information that we have received from the Survey of Family Income and Employment (SoFIE). We strongly recommended that New Zealand start a proper longitudinal survey, aimed specifically at the assets/liabilities and income/expenditure of households. Otherwise we do not know what is really happening, nor whether anything needs 'fixing'.

5.7 Importantly however, the TWG itself has produced no evidence that the existing tax breaks for KiwiSaver have increased the amounts that New Zealanders are saving for retirement.

5.8 The only evidence seemed driven by the fact that, for tax purposes, New Zealand treats retirement saving less generously than other equivalent countries. So what might the international evidence be on tax breaks for retirement saving; do they work in other countries?

5.9 The first point to note is that, despite the universally generous tax treatment that retirement savings receive in other jurisdictions over other savings, there has been remarkably little work done on whether they actually 'work' (improve overall savings, including saving for retirement). It's very difficult, perhaps impossible, to work out because we do not know what might have happened in the absence of the incentives; what economists call the 'counter-factual'[20]. Some studies suggest the overall impact on the quantum of savings and national saving rates is doubtful[21].

5.10 In fact, if households as a whole were *perfectly* rational, they would allow for the value of tax concessions when setting target retirement saving levels. The annual amounts required to meet a given target are less if those savings are subsidised through favourable tax treatment. We should therefore expect lower annual levels of household saving in a tax-favoured environment, like KiwiSaver than under the income tax-neutral model TTE because of the value of the concessions given by taxpayers to the saver's lifetime saving project. Given that tax breaks seem not to 'improve' the quantum of savings (along with the other difficulties described above), the expensive, complex concessions in the EET environment common overseas arguably become pointless.

5.11 As we pointed out in section 2 above, before KiwiSaver started in 2007, New Zealanders were on average probably saving enough for retirement. That was after nearly 20 years of no tax incentives or other 'signals' that we should be saving for retirement in a particular way (such as KiwiSaver itself, auto-enrolment, employer match and tax incentives). This experience might have led us to conclude that KiwiSaver itself was unnecessary because New Zealanders seemed to be behaving rationally without the presumed help that KiwiSaver now offers.

5.12 Instead, we got KiwiSaver, along with relatively generous tax breaks on the members' and employer's contributions (subsequently reduced).

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[20] Spain introduced tax incentives for retirement saving in 1988. A report on household behaviour across their introduction concludes that "at most" only one quarter of the contributions were 'new' savings: see *The Effects of the Introduction of Tax Incentives on Retirement Savings* (2007), Juan Ayuso, Juan Jimeno and Ernesto Villanueva, Banco de España (accessible here). That analysis took no account of the cost to the tax system of lost revenue.

[21] Alicia Munnell in *Current taxation of qualified pension plans: has the time come?* (1992) Federal Reserve Bank of Boston (accessible here) suggests that the costs of deferring tax on pension accumulations aren't justified. Instead, the "taxation of benefit accruals should be shifted to a current basis." In *Tax Incentives to Saving and Borrowing* (2003), Tullio Jappelli and Luigi Pistaferri (accessible here) say "…there is considerable empirical debate as to the effectiveness of tax incentives in promoting saving: most studies conclude that tax incentives affect the allocation of household portfolios, but the effect on the amount saved is less clear-cut." In *The Effects of 401(k) Plans on Household Wealth* (2000 – accessible here), Eric Engen and William Gale suggest that, without regard for the fiscal and regulatory costs, "between 0 and 30 percent of 401(k) balances represent net additions to private savings." If the fiscal and regulatory costs were also included, we think those percentages might turn negative.

5.13 Since it started in 2007, we taxpayers will have spent about $10 billion on KiwiSaver tax incentives to 30 June 2019 and expect to spend another $840 million on existing incentives in 2019/20[22]. No-one, including the TWG, seems prepared to address the question: is what we have (KiwiSaver generally or, specifically, tax incentives for KiwiSaver) actually working? And yet, the TWG proposes spending another $215 million a year (at least)[23] on improving the after-tax returns for some KiwiSaver members.

5.14 So what specific problem is the TWG's recommendations addressing? There isn't a retirement saving problem that we know of; we don't even know whether KiwiSaver is helping to lift overall savings, never mind retirement saving, even retirement saving amongst the group originally targeted in the KiwiSaver Act 2006[24]. If KiwiSaver is not working, that might lead us to think about getting rid of the current annual $800 million concession rather than spending an extra $200 million, as suggested by the TWG.

5.15 Given that the two new tax breaks (removing ESCT on employers' contributions for members' earning less than $48,000; lowering the PIE rates on the lowest marginal tax rates) are aimed at the lowest earners, we must assume that the TWG's objective is to reduce the overall tax burden for the lowest income-earners but only if those earners behave in an 'approved' way (save for retirement in KiwiSaver). This recommendation is made despite the TWG's own acknowledgement that:

> "…the tax system is limited in the extent to which it can encourage additional retirement saving by low- and middle-income earners. This is because low- and middle-income earners face income constraints in their ability to take advantage of tax concessions for saving." (page 51)

5.16 In other words, many of these earners cannot afford to save to take advantage of the existing concessions, never mind be encouraged by the TWG's new suggestions. At best, the TWG's recommendations will be a gift to existing low-paid KiwiSaver members and will have limited to no effect on those who cannot afford to save for retirement.

5.17 So, in the best traditions of New Zealand's public policy initiatives on retirement saving, we don't know if there's a problem, but we will put a bit extra into the pot because it seems the right thing to do. We think that's not good enough and does not improve fairness.

5.18 Submissions

5.18.1. The TWG proposes to increase the tax subsidies given to KiwiSaver members from $840 million a year in 2019/20 to $1.05 billion. We think the TWG should be obliged to provide evidence that, firstly, the current tax breaks increase retirement saving; secondly that the proposed new incentives will improve retirement saving in the targeted group, and thirdly that the new tax incentives increase fairness across the tax system as a whole.

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[22] Estimate from the Treasury's long-term fiscal model, 2016.

[23] TWG report at page 51.

[24] KiwiSaver's purpose, as stated in section 3(1) of the KiwiSaver Act 2006 is "…to encourage a long-term savings habit and asset accumulation by individuals <u>who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement</u>" (our emphasis). Any evaluation of KiwiSaver should address the extent to which KiwiSaver has achieved its stated purpose but the TWG's report does not even attempt that analysis. In fact, KiwiSaver is regressive, poorly targeted, inefficient and ineffective.

5.18.2. We know of no evidence to support any of these three propositions.

5.18.3 The TWG also proposes that this special treatment (and the proposed simplification of the way PIE rates are administered) should apply only to KiwiSaver schemes. The fact that the current Member Tax Credit applies just to KiwiSaver is no justification to extend KiwiSaver's special tax treatment. We therefore recommend that the new favours/treatment, if introduced, should apply to any 'collective investment vehicle' that a saver might use to accumulate financial assets for retirement.

6. Some discussion points on the real issues – on what should really matter

6.1 Tax incentives for retirement saving are complex, expensive, distortionary, regressive, inequitable and inevitably create rising regulatory walls around the favoured vehicles. But, worst of all, they probably don't work. Given that a saver's tax break is another's tax cost and also allowing for the deadweight cost of collecting that tax, they probably don't raise overall savings.

6.2 In our 2017 report *The Missing 2016 Review*, we summarised New Zealand's TTE tax-treatment of 'collective investment vehicles' (CIVs) here. We then summarised the key issues that New Zealand needs to discuss on definitions of 'income' and the need for consistent treatment across the different investment options, including the direct ownership of investments. We also pointed out the significance of 'income' for income-tested aspects of the state's welfare system[25].

6.3 Without repeating those points, we concluded that there is or should be a 'gold standard' for the measurement of any policy (or changes) that affects retirement saving:

(a) The choice of CIV (KiwiSaver, superannuation scheme, PIE, unit trust, group investment fund, life insurance fund or company) should not drive the tax treatment of 'income';

(b) Where the CIV is based should not affect the ultimate tax treatment of 'income' for the individual investor;

(c) The saver should pay the appropriate amount of tax on all 'income', including from a CIV.

6.4 We have already suggested that the TWG's proposals for KiwiSaver fail tests (a) and (b). KiwiSaver already fails test (c) so there is no change there, though we say there should be.

6.5 Some specific notes on the TWG's proposals:

6.5.1 'Fair Dividend Return' (FDR):

(a) The FDR tax treatment of shares outside Australasia distorts the ordinary definition of 'income' and needs review.

(b) We think it would be better to get rid of FDR on overseas assets so that 'income' and capital gains can be taxed consistently. Without removing the FDR regime, it is virtually impossible to create fairness across the tax system.

(c) The current tax treatment distorts a taxpayer's decision. Any attempt to reduce the level of distortion will create unmanageable complexity.

(d) If FDR is to stay on overseas assets, then FDR should also apply to other assets, including New Zealand-based assets though this will create a wider range of issues relating to assets (e.g. the family bach that produces no income).

(e) The goal must be that all assets would be taxed consistently. That is not the case now.

[25] Based on our 2010 report *Towards a more rational tax treatment of collective investment vehicles and their investors*, Working Paper for the Retirement Policy and Research Centre accessible here.

6.5.2 Capital Gains Tax (CGT):

(a) While we think that a CGT will create more inequities than it is capable of solving, if a CGT is introduced it should also apply within a CIV as well as to directly held assets and be applied consistently.

(b) Any CGT regime should be as robust as possible.

(c) The corporate rate could be zero, particularly if the CGT is based on an accruals regime.

(d) On the other hand, if the CGT is an 'end tax', it could be triggered when the saver 'retires'. On this, there are no issues with managed funds and managed funds with PIE status in reserving for CGT – that is what they used to do before the current favoured regime for Australasian shares under the PIE regime was introduced. A CIV would have to reserve for future CGT payments on a disclosed basis.

6.5.3 PIE rates:

(a) Rather than reduce the lowest PIE rates by 5%, as proposed by the TWG, it would be better to put the 28% rate up to 33%. That would make the top PIE rate, top PAYE rate and the tax paid by trusts the same.

(b) Ideally, the corporate tax rate should also be the same 33% or the top rate lowered to 28% in all cases. Given that it could be based on income and capital growth, having a 28% combined rate (versus 33% on income and 0% on growth as is now) may make sense and improve fairness.

6.5.4 Employer Superannuation Contribution Tax (ESCT):

(a) If ESCT is excluded on the employer's KiwiSaver contributions for employees who earn less than $48,000, then many people will start to earn less than $48,000 to capture the concession.

(b) Trusts and family companies will have a tax-based incentive to employ family members.

(c) The introduction of an exemption of ESCT for an employee, favours employees over the self-employed and employees over volunteer workers and beneficiaries. The exemption also disadvantages a family unit where the average income is below $48,000 but one partner is above and one below the $48,000 threshold.

Appendix A – Op-ed

The TWG's recommendations on retirement saving lack evidence

Michael Littlewood
Former Co-director, Retirement Policy and Research Centre
University of Auckland

The Tax Working Group's report *Future of Tax – Interim Report* made three recommendations on the tax treatment of retirement savings:

- Remove 'employer superannuation contribution tax' on the 3% mandatory contributions by employers to KiwiSaver for employees' earning up to $48,000 a year.
- A five-percentage point reduction for each of the lower PIE tax rates but only for savings in KiwiSaver.
- Simplify the way PIE rates are applied for KiwiSaver members.

The TWG's focus on KiwiSaver suggests that New Zealanders, particularly those on lower incomes, aren't saving enough for retirement. The TWG also seems to think that KiwiSaver is the only, or the main way, that New Zealanders <u>should</u> be saving for retirement.

In a startling contradictory admission, however, the TWG acknowledges that New Zealanders might be saving enough for retirement.

The truth is that no-one knows whether that's actually the case. The TWG offered no evidence on this but there have been several relatively recent reports to suggest that New Zealanders seem to be rational about their financial preparations for retirement. That should not be surprising.

By the end of this financial year, we taxpayers will have spent more than $10 billion since 2007 on taxpayer-funded subsidies for KiwiSaver. In 2019/20, another $840 million will head in the same direction, on current rules. The TWG thinks its suggested changes will add a further $215 million to that making a total annual spend of more than $1 billion.

Here's the thing: we don't know whether KiwiSaver is working (raising overall savings); nor do we know whether the billions spent so far on KiwiSaver have changed anything overall. But now the TWG proposes spending even more of our money; to achieve what, exactly?

KiwiSaver was Michael Cullen's baby and he understandably takes a great deal of interest in its 'success', however he measures that. However, I hope that other TWG members can stand back and ask themselves some key questions:

- Is KiwiSaver really working? The number of members, contributions and assets are only a small part of the answer to this. What really matters is whether KiwiSaver has lifted overall savings.
- Are New Zealanders saving enough for retirement? Even if they aren't, should that justify direct intervention through public policy initiatives?
- Have the $10 billion tax subsidies to date and the expected annual $1 billion tax spend actually changed things?
- Why is it that only KiwiSaver qualifies for this special tax treatment?

Where is the evidence for the TWG's proposals on KiwiSaver? There is none but there should be if we taxpayers are to spend more than $1 billion a year. If the TWG's objective is really to make the "tax treatment of retirement savings fairer" (page 6), how can it possibly support enhancing the already special treatment of KiwiSaver? In this context, what does the TWG really mean by 'fairer'?

International evidence suggests that tax breaks for retirement saving are very expensive, distortionary, inequitable, regressive and demand high, growing regulatory walls around affected assets to ensure the incentives are not 'misused'. But worst of all, tax incentives seem not to work (raise overall savings). That's also likely to be the case for KiwiSaver but we need to find out.

Public policy settings should not overtly favour one form of saving over another. Instead, the TWG should be levelling the tax playing field for all savings and savings-related collective investment vehicles so that everyone pays their appropriate amount of tax. That's what a 'fair' tax system should look like.

604 words

Appendix B – press release

The TWG's recommendations on retirement saving lack evidence and substance

Pension researchers Michael Chamberlain and Michael Littlewood have today released a scathing submission on the Tax Working Group's KiwiSaver recommendations. The TWG has recommended that taxpayers spend an extra $215 million a year on further tax incentives for retirement saving, aimed at the lowest-paid KiwiSaver members.

Chamberlain and Littlewood published a report last year (*The Missing 2016 Review*) that raised many questions about New Zealand's retirement income framework, including about whether taxpayers should be subsidising KiwiSaver.

Michael Littlewood says that we taxpayers will have spent more than $10 billion since 2007 on taxpayer-funded subsidies for KiwiSaver. In 2019/20, another $840 million will head in the same direction. The TWG suggests its changes will add a further $215 million to that making a total annual spend of more than $1 billion just on KiwiSaver subsidies.

"But they haven't asked the question – is KiwiSaver actually working? Where is the evidence that New Zealanders are saving more since 2007, when KiwiSaver started? The TWG actually acknowledged that we all might be saving enough for retirement but then didn't connect the dots. If that's really true, why are we taxpayers spending anything on KiwiSaver, never mind an extra $215 million?"

Littlewood says that the international evidence doesn't support the case for tax-based subsidies to retirement saving.

"They are very expensive, distortionary, inequitable, regressive and demand high, growing regulatory walls around affected assets to ensure the incentives are not 'misused'. But worst of all, tax incentives seem not to work (raise overall savings). That's also likely to be the case for KiwiSaver but we need to find out."

The TWG says it wants to make the overall tax system 'fairer'. Littlewood says that the TWG's definition of 'fair' misses the mark on KiwiSaver. He says that New Zealanders save for retirement in lots of different ways. After 11 years, the average KiwiSaver member's balance is just $17,130, so that's only one way they save. The job of a 'fair' tax system is to let New Zealanders decide what's best for them, not to point them into any particular way of saving. Littlewood says that it's fundamentally wrong for KiwiSaver to have a tax advantage over, for example, a workplace savings scheme.

"Tax settings should not overtly favour one form of saving over another. If the TWG's recommended capital gains tax happens, the rational saver will shift savings into international shares. Tax will be driving behaviour even more strongly than now.

"Instead, the TWG should be levelling the tax playing field for all savings and savings-related collective investment vehicles so that everyone pays their appropriate amount of tax. That's what a 'fair' tax system should look like."

451 words