Tax Working Group
Te Awheawhe Tāke

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AMP CAPITAL

SUBMISSION TO THE TAX WORKING GROUP

FUTURE OF TAX

PREPARED BY AMP CAPITAL INVESTORS (NEW ZEALAND) LIMITED

1 November 2018

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AMP Capital Investors (New Zealand) Limited

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INTRODUCTION

> We take this opportunity to thank the Tax Working Group and Officials for the effort and consideration they have undertaken in producing the interim report.

> We do not necessarily agree with some of the comments in the report, and set out below are our thoughts and concerns on the content of the interim report.

ECONOMIC EFFICIENCY AND FAIRNESS

> A major principle behind the proposals for the Tax Working Group is fairness.

> Any capital gains tax (CGT) needs to be a comprehensive in order to be fair – that is, providing a level playing field.

> Given the family home has been excluded from the Tax Working Group's Terms of Reference, the introduction of a capital gains tax would not meet the criteria of a comprehensive CGT.

SPECIFIC COMMENTS AND RECOMMENDATIONS

> Taxpayers will have implementation issues for any proposals adopted from the interim report, due to the timing of the next Government forming in November 2020, confirmation of legislation by that Government likely to be December 2020, and the effect of legislation being 1 April 2021.

- Businesses will be reluctant to undertake information technology (IT) design, build and testing prior to any proposals, such as the taxing of capital gains, until they are confirmed by the then Government.
- This leaves a short period of time of four to five months to undertake IT build and testing before the effective date of legislation.
- Depending on the design of the proposals, including the complexity of any capital gains tax, it is likely 12 to 18 months will be needed to undertake IT build and implement the appropriate changes.
- Corporate taxpayer's IT resources are, and will be, in the lead up to 1 April 2021, utilised to build other tax changes and reporting due to Inland Revenue's Business Transformation programme, eg payday reporting and Common Reporting Standards (CRS) requirements.
- Inland Revenue will also need to undertake IT system changes for the implementation of Government proposals, and they will have the same issues as taxpayers.
- We recommend that the implementation of any Tax Working Group proposals adopted by the then Government is deferred to at the earliest 1 April 2022, due to the issues outlined above.

Quality of legislation

> There is a short timeframe for drafting the legislation of around three months for any Tax Working Group proposals adopted by the Government based on the current timings.

> Given the potential complexity of some of the proposals, ie taxing capital gains, it would be better for Policy Officials to spend more time designing, drafting and obtaining feedback from taxpayers. This requires longer than the usual six weeks on the proposed legislation, rather than rushing it through and having to spend time fixing issues and errors.

> It is a waste of both Policy Officials and taxpayers' time to go back and deal with fixing issues, errors on legislation and making changes, due to practical implications because it's been rushed through the process.

Capital Gains Tax

> There needs to be consideration and understanding of the impact on the New Zealand capital markets of introducing new tax regimes like taxing capital income (CGT), as well as how non-resident investors will be treated under such a regime.

> The effect of any capital gains tax introduced on New Zealanders needs to be considered and factored in, including:

- as taxpayers will be paying CGT to the Government on certain assets this will lead to lower level of retirement savings for individuals,
- individuals will have lower levels of income in retirement due to having decreased level of retirement savings or assets,
- the lower levels of retirement income will result in more reliance on superannuation provided by Government,

- whether moving to an EET (Exempt-Exempt-Taxed) approach for retirement savings would mitigate some of the impact of CGT on individual's retirement assets, savings and income. Under an EET regime, contributions are made out of gross income, investment earnings would be tax exempt and withdrawals would be taxed.

> If CGT is introduced, a staged approach should be considered and this could be determined by asset class. This would allow sufficient time for:

- consideration of whether a CGT on a particular type of asset is appropriate, such as shares
- the targeting of asset classes that are considered problematic, ie residential properties
- consideration and resolution of issues relating to specific types of assets, such farms that have a business part as well as a family home portion, and
- Inland Revenue and taxpayers in agreeing the cost base of assets in a timely manner (four years).

> The more complex the CGT rules or regime, including exemptions, roll over relief and change in use of assets, the more IT system design, build and testing as well as processes and compliance work that will need to be undertaken by taxpayers, their advisors and Inland Revenue.

> The introduction of a CGT regime will introduce significant record keeping requirements for all taxpayers.

- Has thought been given to how taxpayers will meet the record requirements of the cost of an asset when an asset is sold say in 20 years' time?
- Further, how will the current statute bar rules work under a CGT regime, especially when assets are realised after significant time periods?
- Should there be upfront agreement between Inland Revenue and taxpayers on asset cost bases?
- What will be the ongoing filing requirements for asset cost bases for taxpayers?

> Has a proper costs/revenue analysis of CGT been undertaken for this proposal that considers everyone, ie all forms of taxpayers, Inland Revenue, etc? Does this include the initial costs of complying, eg valuations, ongoing costs, and additional New Zealand superannuation payments due to lower retirement savings been undertaken?

> There needs to be consideration and removal of any double taxation issues, such as taxing capital gains in listed PIEs and then taxing entities such as multi-rate PIEs on the shares they own in listed PIEs.

PIE CONSIDERATIONS

> The purpose of the PIE regime is to ensure the same outcome is achieved between individuals investing directly and those investing through managed funds. If this fundamental methodology is to remain, then the following considerations need to be undertaken.

> Any double taxation issues for PIEs and PIE investors are eliminated.

> If the accrual method is adopted for taxing all shares in PIEs:

- this would provide a practical and workable solution given it is currently used for some forms of investments
- this would remove the fair dividend rate (FDR) method and hedging issue
- this should also be extended to all other investors. If it is not possible to extend this to other investors, then a rate of discount should be provided to all PIEs, so that their investors are not disadvantaged, ie they achieve a similar outcome to those investing directly.

> If the foreign investment fund (FIF) rules and the fair dividend rate (FDR) method is adopted for taxing all equities:

- it would assist if this regime is simplified. That is, there is only one method to apply that is only FDR, rather than having FDR and CV (comparative value) for any non-ordinary shares
- the current rate of FDR at 5% is too high in comparison to the actual risk return rate and should be reset
- the rate of any applicable FDR should be regularly reviewed, ie biennial, and any reset or change in rate, if required, be issued via determination by Inland Revenue
- the FDR hedging rules were introduced to overcome the FDR and hedging issue. These rules are complex and in practice difficult to apply. Consideration needs to be given to simplifying these rules as well as widening the application of them, such as to PIEs that invest in other PIEs that hold securities subject to FDR
- FDR is the tax methodology that most investors struggle to understand, including how the rate is set. Education from all parties, including Inland Revenue and Government, will continue to be important so that individual taxpayers understand the approach.

Other considerations

- The adoption of any transition rules and/or transition period for moving from the current approach to any new approach, eg for the introduction of taxing capital income.
- The current unpaid role of institutions as tax collectors and data/information gatherers and providers for Inland Revenue and the New Zealand Government needs to be considered. These entities should be compensated for the costs they incur in undertaking these roles for Inland Revenue and the Government.
- The introduction of new prescribed investor rates (PIRs) for KiwiSaver funds which will be different to those for multi-rate PIEs.
  - We query whether this proposal will achieve its objective of lower income taxpayers saving more given their level of income.
  - For providers of PIE IT platforms, new PIRs for KiwiSaver PIEs may cause some issues as PIR rates will be determined by PIE entity type rather than across all PIE types.
  - Generally, KiwiSaver and retirement schemes invest in wholesale funds (that are also PIEs) which hold the securities etc. There needs to be practical consideration undertaken on how the different PIRs and any income or information requirements will work throughout all PIE layers.
  - For providers that have investors who hold KiwiSaver funds and other investments not entitled to the new PIR rates, eg a superannuation fund, their system will need to store two tax rates for investors. This will most likely expand the data held and require IT system build.
  - There will need to be an educational piece around individual investors understanding why they can only have a particular tax rate for a specific entity type, if PIRs are different between KiwiSaver and retirement schemes.

EDUCATION OF NEW ZEALANDERS

- There will need to be a large piece of work on educating what the proposals adopted means for all taxpayers – from large corporates to individuals. This would include explaining what and how adopted approaches work.
- There will also need to be a behaviour change piece, as taxpayers will need to file individual income tax returns, or at the very least go in and confirm information held by Inland Revenue due to taxing capital income or gains. This will be a major change in behaviour for at least one, if not more, generations of New Zealanders who have not filed income tax returns under the current regime.
- Inland Revenue and wider Government will need to take a large role in educating all taxpayers on what any rules are, and changing behaviours such as all taxpayers filing income tax returns, even if this is through a confirmation approach.

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