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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Smartshares Limited – Submission to the Tax Working Group

1. Thank you for the opportunity to submit on the "Future of Tax Interim Report" that was published on 20 September 2018 (**Report**) by the Tax Working Group (**TWG**).

2. Smartshares Limited (**Smartshares**) is a wholly owned subsidiary of NZX Limited. This submission related to matters raised in the Report that are relevant to the funds management industry. Smartshares is providing this submission in its capacity as a licensed managed investment scheme manager, rather than as a member of the NZX Group.

Background

3. Smartshares Limited provides funds management services across a suite of investment funds and superannuation products. Smartshares has over $3 billion funds under management representing investments from over 80,000 New Zealanders.

4. Smartshares is the licensed manager of the Smartshares Exchange Traded Funds managed investment scheme (**ETF scheme**). The ETF scheme comprises 23 exchange traded funds that are listed on the NZX Main Board, providing exposure to domestic and international investments. Each fund within the ETF scheme is a listed portfolio investment entity (**Listed PIE**).

5. Smartshares is also the licensed manager of certain superannuation schemes and a KiwiSaver scheme that are offered under the SuperLife brand[1]. These schemes invest in SuperLife Invest, a unit trust managed by Smartshares which is an unlisted Multi Rate PIE (**MRPIE**).

Submissions on the Interim Report

6. We set out below our submissions on certain aspects of the Report that are relevant to the funds management industry.

Imposition of a Capital Gains Tax (CGT)

7. The Report includes detail of the manner in which a CGT could be imposed upon certain assets, including property and shares. Smartshares does not support extending the CGT to include currently untaxed capital gains on shares issued by New Zealand and Australian issuers.

[1] These schemes are: the SuperLife KiwiSaver scheme; the SuperLife workplace savings scheme; and the SuperLife UK pension transfer scheme.

CGT Design

8. Notwithstanding our submission in paragraph 7, if a CGT is to be introduced we make the following submissions regarding the design of a CGT.

9. We support the alignment of taxation treatment across different investment methods and investment types, so as to eliminate distortions to investment decisions based on differential tax treatment. If the tax treatment differs between investments held directly; or, indirectly via PIEs, Kiwisaver schemes or other vehicles; investors would be expected to act rationally and, in the absence of any other incentive, to direct their investment to the method of investment with the lowest tax burden. This may not be the most efficient or lowest cost option.

10. Similarly, we submit that differential tax treatment based on the nature of an investment class (New Zealand shares, foreign shares, property, derivatives, etc.) incentivises investors to invest in the most tax beneficial manner, distorting their investment decision away from considerations such as the risk of the product, or environmental and social considerations. In this regard, we note:

    - If a CGT applies to shares issued by New Zealand issuers, but the fair dividend rate method (**FDR**) is retained for foreign shares, the CGT will act as a disincentive to investment in New Zealand companies. This could have a negative effect on New Zealand companies' ability to raise capital, and consequentially on productivity and employment for the broader New Zealand economy.

    - Individuals and trusts have the option of electing either FDR or the comparative value method (**CV**) to apply to the taxation of foreign share investments, whereas managed funds do not. This is an incentive towards direct investment as individuals can choose the better tax outcome between the two methods year on year, which funds cannot. Investing directly rather than through a collective investment scheme may not otherwise be in the best interests of the investor.

    - If a CGT is introduced on the realised gains on direct investments in shares and capital gains on indirect investments (e.g. MRPIEs and Listed PIEs) remain exempt, a strong incentive for investors to invest indirectly through PIEs would be created. This would have a negative impact on the capital markets, creating inefficiency and increasing the cost of capital for issuers.

11. We recognise that a balance needs to be struck between fairness, simplicity and tax base protection measures which encourage involvement in capital markets and an appropriate level of household savings. In our view, consistency in tax treatment across entities and investment classes will be critical to achieve this.

CGT for PIEs

12. Smartshares is one of the main users of the Listed PIE structure - our 23 ETFs are all Listed PIEs. These unit trusts are taxed as companies, with the same treatment of investments as MRPIEs (gains on New Zealand and Australian shares are currently tax exempt). Distributions are taxed as dividends and are excluded income to the extent that imputation credits are not attached (rather than the attribution method for MRPIEs).

13. While we do not support the imposition of a CGT on shares, we submit that imposing a CGT for MRPIEs on a realised basis will be unduly complex, and see the imposition of a CGT on an accruals basis as less complex, with an appropriate discount rate to reflect the time value of money.

14. We understand that options being considered for a CGT on Listed PIEs are either: to mirror the MRPIE treatment (with no tax on sales of units in the managed fund at the investor level); or, to tax Listed PIEs on a realised basis with investors taxed on unit sales (but no taxation on the capital gains that accrue to the managed fund through its investments and with imputation credits passing through to eliminate double taxation to an extent).

15. We support changing the tax treatment for Listed PIEs to mirror the treatment for MRPIEs, with no CGT on the sale of units at the direct investor level. This maintains consistency in tax treatment across PIE entities, and more importantly it means that investors would not have to deal with CGT compliance in their personal tax returns.

PIEs more generally

16. In the context of share investments, we consider that the Listed PIE structure is less useful than a MRPIE structure in ensuring proportionate and efficient treatment of different investor classes. The MRPIE structure allows lower tax bracket investors to be taxed correctly up-front, and removes the hurdle of requiring the investor to file a return to receive excess refund imputation credits.

17. While a MRPIE is able to be listed, an operational barrier exists in that for this to become common place, there would need to be significant upgrades to Registries' systems to enable the calculation and attribution of PIE tax to investors at the correct rate. That capability is not currently in the market, hence our continued use of the less customer friendly structure for the ETFs. We submit that removing the Listed PIE structure and mandating a MRPIE structure would ensure better tax outcomes for New Zealanders by removing this hurdle.

System issues

18. Any implementation of a CGT at the PIE level will require system changes which may be problematic and expensive for some operators. In our view, we are well placed to make the systems upgrades necessary if an accrued CGT is implemented.

Retirement savings

19. The Report recommends removing ESCT on employer Kiwisaver contributions for members earning less than $48,000 per year. We support this recommendation, however we consider that there will be issues for employers in determining which employees qualify for the ESCT exemption i.e. if secondary jobs or other income is included. We submit that consideration should be given to how this proposal could be simplified for employers in a way that maintains the intent of the exemption.

20. The report also recommends reducing the lower PIE rates for Kiwisaver funds by 5 percentage points each. Again, we support the policy initiative to encourage retirement savings for investors in the lower tax brackets, however as noted in our earlier comments, any difference in tax rates or treatment between different investment classes will distort investment decisions. We submit that consideration should also be given as to the effects of differential tax treatment where a member is over 65 (where funds invested

in Kiwisaver schemes are no longer "locked-in", and in effect no different to regular PIEs).

21. We understand investors currently find it difficult to correctly determine their applicable PIE rate, and support the simplification of the determination of elected PIE rates.

Tax rules for the investment industry

22. While not within the ambit of the TWG's terms of reference, we encourage the Government to take this opportunity to consider the taxation treatment of the New Zealand investment industry more generally, particularly with a view to making New Zealand based investment structures more attractive to foreign investors and more competitive against funds domiciled offshore that are becoming increasingly available to New Zealand investors.

23. In particular, we would support any initiative to simplify and improve the Foreign Investment PIE regime to improve the international competitiveness of New Zealand domiciled funds. We note the launch in Australia of the CCIV fund structure. We consider that such an initiative would align with the Asia Regions Fund Passport initiative, which is currently in the process of being legislated, and would enable New Zealand to position itself as a domicile for regional cross-border funds management. The New Zealand tax implications of New Zealand's commitment to the Asia Region Funds Passport must be included in this review alongside the review of other tax settings for New Zealand PIE funds.

We would welcome an involvement in any consultation in this area to expand on our concerns.

Yours faithfully,

[1]

Hugh Stevens
Chief Executive Officer
Smartshares Limited