

# Hon David Parker, Minister of Revenue

## Information Release

### GST on Fees Charged to Managed Funds

September 2022

#### Availability

This information release is available on Inland Revenue's tax policy website at <https://taxpolicy.ird.govt.nz/publications/2022/2022-ir-cab-dev-22-sub-0134>

#### Documents in this information release

#	Reference	Type	Title	Date
1.	PUB 001-017	Public submissions	Extracts from public submissions received on the 2020 GST Policy Issues: an officials issues paper.	Last submission received 26 May 2020.
2.	IR2022/152 T2022/848	Tax policy report	GST treatment of services supplied to managed funds	12 April 2022
3.	IR2022/240 T2022/1190	Tax policy report	Cabinet paper – GST on fees charged to managed funds	26 May 2022
4.	DEV-22-SUB-0134	Cabinet paper	GST on Fees Charged to Managed Funds  Note: The regulatory impact assessments and statements attached to the paper are publicly available	22 June 2022
5.	DEV-22-MIN-0134	Minute	GST on Fees Charged to Managed Funds	22 June 2022

#### Additional information

The Cabinet paper *GST on Fees Charged to Managed Funds* (DEV-22-SUB-0134) was considered by the Cabinet Economic Development Committee on 22 June 2022 and confirmed by Cabinet on 27 June 2022.

One attachment to the Cabinet paper is not included in this information release as they are publicly available:

- Regulatory impact assessments and statements:
  - [GST on management services supplied to managed funds](#) (25 May 2022)

#### Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the OIA). Where this is the case, the relevant sections of the OIA that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the OIA under which information was withheld:

- 9(2)(a) to protect the privacy of natural persons, including deceased people

- 9(2)(b)(ii) to protect the commercial position of the person who supplied the information or who is the subject of the information
- 9(2)(f)(iv) to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- 18(d) information is already publicly available or will be publicly available soon

The submissions contain information that is outside the scope of this proactive release of GST on Fees Charged on Managed Funds. This information has not been considered for release and is withheld as "not in scope". Where a full page is "not in scope" these have been removed from the document.

Submissions that are publicly available:

CA ANZ <https://www.charteredaccountantsanz.com/news-and-analysis/advocacy/policy-submissions/gst-policy-issues-an-officials-issues-paper>

New Zealand Law Society <https://www.lawsociety.org.nz/assets/Law-Reform-Submissions/I-IR-GST-Policy-Issues-Issues-Paper-26-5-20.pdf>

### **Accessibility**

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# Inland Revenue

## Public submissions received on GST Treatment for Management Services Supplied to Managed Funds

September 2022

Submission number	Submitter
PUB-001	Implemented Investment Solutions
PUB-002	Police Superannuation Scheme (PSS)
PUB-003	Russell Investment Group Limited
PUB-004	Public Trust
PUB-005	Ernst & Young Limited
PUB-005a	Ernst & Young Limited
PUB-006	Pathfinder Asset Management Limited and Alvarium Wealth (NZ) Limited
PUB-007	Fisher Funds Management Limited
PUB-008	Corporate Taxpayers Group
PUB-009	PwC
PUB-010	UniSaver Limited
PUB-011	MISS Scheme
PUB-012	Ernst & Young Limited
PUB-013	Trustee Corporations Association of New Zealand Inc (TCA)
PUB-014	Milford Asset Management Limited
PUB-015	Financial Services Council of New Zealand
PUB-016	Chapman Tripp
PUB-017	Deloitte

## GST Treatment for Management Services Supplied to Managed Funds

Submitter: Implemented Investment Solutions  
Contact details: s 9(2)(a)

Please contact us if you would like to discuss this submission.

Implemented Investment Solutions Limited (“IIS”) is a fund management company specialising in establishing and managing New Zealand-domiciled funds. In particular, we provide a “Fund Hosting” service which is similar to the third party responsible entity services that are available within the Australian market. Fund Hosting involves the issuing and managing of funds, under IIS’s MIS licence, on behalf of an investment manager who wants to provide NZ investors with access to their investment solutions in PIE funds.

In our Fund Hosting business we see a variety of GST treatments. For example, offshore investment managers who provide services to NZ domiciled funds do not generally charge GST. Conversely NZ domiciled investment managers, providing the same services, generally charge GST at 1.5% (10% of the full 15% rate).

We don’t have a strong preference for any of the options considered in Chapter 7 of the GST policy issues paper. We do, however, strongly believe in a consistent GST approach for managed funds. In particular, there should be consistency by:

- Savings vehicle type, including managed funds, KiwiSaver schemes, and Australian unit trusts, and
- Business model.

### Savings vehicle type

The GST policy issues paper highlights the current GST exemption for management of a retirement scheme, and that non-retirement savings schemes do not have a similar exemption. In addition, we note that foreign funds offered in NZ, in particular Australian Unit Trusts offered under mutual recognition, are not subject to NZ GST.

To ensure a level playing field, all genuine savings vehicles, regardless of the savings need being targeted and the jurisdiction of the vehicle, should have the same GST treatment. This extends to KiwiSaver schemes, which should have the same GST treatment as savings vehicles like managed funds.

### Business model

The GST policy issues paper highlights the potential discrepancy in GST treatment depending on whether services are provided in-house or they are outsourced. In addition, as noted earlier, GST treatment can vary depending on if a service is being provided by a foreign or NZ entity.

All services provided to genuine savings vehicles, regardless of the services being provided in-house, outsourced or provided by a foreign entity, should have the same GST treatment. This will reduce bias towards a particular business model.



GST policy issues  
Deputy Commissioner, Policy and Strategy  
Inland Revenue Department  
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s 9(2)(a)

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### **Submission on GST Policy Issues Paper**

The Police Superannuation Scheme (PSS) welcomes the opportunity to make a submission on this paper.

The PSS is the Workplace Savings scheme providing retirement savings to sworn police and other police employees. It is compulsory for sworn police to join the scheme. As at 29 February 2020 it managed s 9(2)(b)(ii). It is the largest Workplace Savings scheme in New Zealand.

The PSS is concerned with Chapter 7 of the paper (Managed Funds) which affects it directly. In particular, we would like to comment on one of the proposed options set out in paras 7.23 – 7.27: “Making all management services supplied by investment managers and other fund managers taxable supplies”. As stated in the paper in 7.26 this option would result in “higher fees and reduced after tax returns” for our members. Our funds have no structures whereby we can pass GST on – the additional tax burden on stops with members.

In our view, this is entirely inappropriate in a time when the encouragement of retirement savings is very important and at a time, which would be during or soon after members had suffered significant losses because of the COVID-19 pandemic.

We therefore have a strong preference for one of the other options.

I would be happy to discuss the points raised with officials, if required.

Yours sincerely,

s 9(2)(a)

## GST Treatment for Management Services Supplied to Managed Funds

Submitter: Russell Investment Group Limited  
Contact details: s 9(2)(a)

Please contact us if you would like to discuss this submission.

Russell Investment Group Limited ("RIGL") is part of Russell Investments, a leading global investment manager offering multi-asset solutions to both institutional and retail clients in over 30 countries.

RIGL provides investment management services to managers of New Zealand-domiciled funds and consulting services to New Zealand-domiciled clients who invest in both domestic and offshore products.

As commented in the paper, there are currently varying practices in the industry and a consistent approach that is equitable across business models and savings vehicles is welcome.

The policy options outlined each have their benefits and drawbacks as outlined in the paper.

Our comments with respect to each option are noted below:

### **1) Making all management services supplied by investment managers and other fund managers taxable supplies**

In our view, this option reduces complexity and biases when compared to options 2 and 3 below, if it applies to all types of savings vehicles whether they be retirement schemes or other types of managed funds. Therefore, the exemption which is currently in place for retirement schemes should be removed. All managers and schemes would be on an even playing field.

There will be less uncertainty on the GST treatment as essentially, all services provided by managers and investment managers would be subject to GST at the current rate of 15%. They will also be able to claim in full the GST on their inputs. For companies that provide both investment management and consulting or any other taxable services, it would reduce the complexity and administrative burden that currently exists in determining the recoverable and unrecoverable GST on costs which support both taxable and exempt activities.

A significant drawback to the above, however, is that this will increase costs to the investor. If the Government wants to encourage savings, then this policy option may be a significant deterrent to such an outcome. As noted in the paper, other jurisdictions allow funds to claim a portion of the GST via a reduced input tax credit mechanism.

### **2) Exempting all management services supplied by investment managers and other fund managers**

The advantage to this option is the elimination of the discrepancy that currently exists between services that are provided to retirement schemes vs other savings vehicles. In addition, it will further reduce GST cost for funds and underlying investors but at a cost to the manager / investment manager who will not be able to claim any input tax credits relating to those services. As a result, this option will likely create more biases against outsourcing as providing the services in-house incurs no GST whilst outsourcing to 3<sup>rd</sup> party providers results in added costs due to unrecoverable GST. This is not an ideal outcome if outsourcing the services is beneficial for both the manager / investment manager and investors. In addition, as noted in the paper, it will likely create incentives to bundle services and characterise them as "management services" to reduce the GST costs for the funds.

From an administrative and compliance standpoint, unless the manager or investment manager only provides exempt management services, it will not reduce the complexity that current exists for companies that provide both taxable and exempt supplies.

**3) All management services supplied by investment managers and other fund managers have both a taxable and exempt component**

The difficulty with this option is determining the appropriate split between the taxable and exempt portions. There are likely to be varying opinions in the industry due to varying business models. If a decision is made to apply the 90% exempt / 10% taxable split that is currently being applied by some in the industry, it will lessen the burden of the transition, though it will be at the expense of those who currently treat fees as 100% taxable. From an administrative and complexity standpoint, we see no significant benefits from this option.

**4) Zero-rating or a reduced input tax mechanism**

We view the zero-rating option as the most preferred. This will encourage savings by decreasing fund fees for investors, allow NZ based savings products to compete more effectively with global counterparts which benefit from reduced input tax regimes or a wider array of services that are exempt from GST, reduce bias against outsourcing and will likely have broader support from industry participants. However, we do acknowledge that management and investment management services would need to be carefully defined for this treatment.

A reduced input tax mechanism would also be welcome, though to a lesser extent compared to zero-rating as determining an appropriate percentage of recoverable GST may prove to be difficult. In addition, this option will be more complex to administer as funds will now be able to claim input tax credits.

In terms of transition, we request Inland Revenue to allow for adequate time to comply with the chosen option. Fund management fees are complex and charged in a variety of ways and companies will need sufficient time to understand the impact of the changes, develop a transition plan, implement the plan and communicate to all relevant parties, including investors.





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5<sup>th</sup> May 2020

GST Policy Issues  
C/- Deputy Commissioner, Policy and Strategy  
Inland Revenue Department

By email: [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz)

Dear Deputy Commissioner,

**Re: GST Policy Issues Paper, February 2020**

Public Trust is pleased to provide a submission on the options and proposals outlined in the GST policy issues paper. Public Trust has provided comments on the chapters and topics that directly affect Public Trust’s existing and foreseeable operations.

**Specific Comments**

The following table provides a breakdown of Public Trust’s feedback.

Chapter and topic	Issue	Comments
Not in scope		

Not in scope

<p>Chapter 7 – Managed funds</p>	<p>The GST treatment of different types of management services supplied to managed funds is complex and applies inconsistently.</p>	<p>Public Trust agrees there is a need for more certainty in the GST treatment of fund manager and investment manager services. Public Trust places importance on the policy objectives of <i>providing certainty of treatment</i> and <i>minimising biases that GST may create</i>.</p> <p>Unfortunately there is no approach that perfectly meets these objectives, there are trade-offs for each option. Public Trust’s views on each option are as follows:</p> <p><b>Making all management services supplied by investment managers and other fund managers taxable supplies</b></p> <ul style="list-style-type: none"> <li>• This option provides certainty of treatment and appears to be the option with the lowest compliance costs for investment and fund managers, both of which are perceived positively by Public Trust.</li> <li>• The tax biases from inconsistencies between GST treatment of retirement schemes and investment managers and the higher fees and resulting reduced after-tax returns for retail investors are significant drawbacks.</li> <li>• Due to the reduced returns for Public Trust clients and creating biases against investment managers this option is not favoured.</li> </ul> <p><b>Exempting all management services supplied by investment managers and other fund managers</b></p> <ul style="list-style-type: none"> <li>• This option would provide improved certainty for service providers but compliance costs are greater than for the previous option.</li> <li>• To aid certainty of treatment Public Trust agrees there’s a strong need to develop a robust definition of the services that qualify for the GST exemption.</li> <li>• The GST costs for managers and the boundary issues are unfortunate by-products of this option but are issues that are currently experienced by financial services providers so Public Trust does not consider these to be significant as there is a consistency across</li> </ul>
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		<p>the industry for the cost impact and a framework for dealing with the boundary issues.</p> <ul style="list-style-type: none"> <li>Public Trust has a preference for this option.</li> </ul> <p><b>Legislate that managers and investment managers are deemed to have a certain percentage of taxable and exempt supplies</b></p> <ul style="list-style-type: none"> <li>This option would introduce complexity and inconsistency into NZ's GST regime by apportioning output tax on supplies.</li> <li>However to legislate a percentage would improve certainty.</li> <li>The GST costs on managers would be less than under the full exemption option above but introduces further opportunity for biases and complexity due to inconsistencies with the GST approach for financial services.</li> <li>Public Trust is aware that 90% exempt, 10% taxable is followed in parts of the industry but cannot advise at this stage what may be a reasonable percentage if this option was adopted.</li> </ul> <p><b>Zero-rating or a reduced input tax credit mechanism</b></p> <ul style="list-style-type: none"> <li>While this option would be the most tax advantageous to investment managers such as Public Trust, we concur with the issues paper that such an option will be a fundamental change to the GST treatment of financial services and therefore would more appropriately be considered as part of a fundamental review of the financial services definition that considered the full range of financial services, not just manager and investment manager services.</li> <li>Furthermore Public Trust foresees that the high fiscal cost to the government of the zero-rating option would make it the least favoured for Inland Revenue.</li> </ul> <p><b>Types of manager and investment manager services the proposed policy should apply to:</b></p> <p>Public Trust agrees with applying the existing definitions under the Financial Markets Conduct Act 2013 for the terms <i>manager</i>, <i>investment manager</i> and <i>managed investment scheme</i>. Public Trust also considers it sensible to draw a distinction between providing management services and other services such as accounting, administrative and registry services. Public Trust is not in favour of legislative change to codify the GST treatment of accounting, administrative and registry services and is comfortable with continued reliance on the case law of <i>Databank Systems Ltd v CIR (1987)</i>.</p>
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		<p><b>Transitional issues</b>          If the law was changed Public Trust agrees with the proposal for this change to have effect prospectively with grand-parenting of existing contracts for 3 years to allow for adjustments and new contracts to be negotiated.</p>
<p>Not in scope</p>		

**Conclusion**

Public Trust supports the review of the Goods and Services Tax Act 1985 in response to changes in technology, business practices, and jurisprudence in the interests of maintaining the certainty, efficiency and fairness of New Zealand’s tax system.

Given the importance of these proposed changes, we are happy to provide any additional comment on the contents of this submission. Please do not hesitate to contact us.




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Thank you for considering our feedback.

Kind regards,

s 9(2)(a)

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8 May 2020

Ref: 61242770/21890243

s 9(2)(a)

Via email: [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz)

## Submissions on Goods and Services Tax GST treatment of management services supplied to managed funds

Dear Sir / Madam

On behalf of the fund managers noted below, we have been engaged to make a joint submission in respect of the policy options for changing the GST treatment of manager and investment manager services supplied to managed funds. We refer to “Chapter 7 – Managed Funds” of the “GST policy issues – an officials issues paper” dated February 2020.

The fund managers are as follows:

- ▶ Mint Asset Management Limited;
- ▶ Castle Point Funds Management Limited;
- ▶ Devon Funds Management Limited;
- ▶ Elevation Capital Management Limited;
- ▶ Nikko Asset Management New Zealand Limited; and
- ▶ SALT Funds Management Limited.

We appreciate the opportunity to make a submission on the above-mentioned GST issue and have set out our submission below in this regard. All legislative references are to the Goods and Services Tax Act 1985 (the “Act”) unless otherwise stated, paragraph references are to the document unless otherwise stated.

### 1. General comments

- 1.1 The fund managers support the policy option to treat the management services supplied by investment managers and other fund managers to managed funds as fully taxable for GST purposes. Please note that our discussions set out in this submission are consistent with our previous submission dated 5 July 2018 (as enclosed), although noting that the previous submission was structured as a hierarchy of preferences (considering the limited policy options available at the time) whereas we have indicated our preferred approach in the current submission.
- 1.2 We consider that the policy option to treat the management services as fully taxable would provide the much needed clarity on this area (i.e. any arbitrary boundary issues can be notably minimised) and this option is consistent with the primary policy objective of GST being a broad based tax policy.

1.3 The fund managers also agree that the terms “manager”, “investment manager” and “managed investment scheme” could be defined under the Act by referencing the existing definitions of these terms in section 6(1) and section 9 of the Financial Markets Conduct Act 2013.

1.4 The fund managers’ submission is set out in further detail below.

## **2.0 Management services performed by the fund managers and the GST treatment of these services**

2.1 The fund managers are of the view that the majority of the activities undertaken by the fund managers should be taxable for GST purposes and we consider that the essential nature of the activities undertaken by the fund managers is managing the funds, being a management service.

2.2 We have listed below the activities undertaken by the fund managers (please note that this list is not exhaustive) and we are of the view that these activities should be treated as a single taxable supply for GST purposes as they are in the nature of “management services” and should not fall under the definition of “financial services” under the Act.

- ▶ research on securities and stock positioning;
- ▶ marketing and advertising of the fund;
- ▶ communication with investors through written communication and online portals for tailored investor information;
- ▶ provision of general market commentary and answering client queries on fund;
- ▶ maintaining legal compliance with securities law, including document preparation and anti-money laundering operations and arranging audit;
- ▶ preparation and distribution of audited accounts and arrangement of the audit;
- ▶ maintenance of a unit register;
- ▶ valuing assets and calculating unit prices;
- ▶ compliance with extensive reporting requirements to the funds supervisor and regulator;
- ▶ providing tax advice required by the fund;
- ▶ completing stress testing as required by the Financial Market Authority;
- ▶ reviewing offer materials and meeting with potential fund investors;
- ▶ preparation of a Compliance Assurance Programme.

2.3 The essential nature of the above services is a management service, and not merely the execution of trades.

## **3.0 Advantages of treating the management services as fully taxable**

3.1 There are significant advantages by treating the management services as fully taxable for GST purposes. We have discussed the same in further detail below.

***Reduces compliance costs***

- 3.2 Treating the management services as fully taxable would simplify the compliance processes and significantly reduce the associated compliance costs.
- 3.3 Compliance costs add up when there is a need to identify and determine the GST treatment of the different types of services and to quantify the consideration for each service. In addition, significant compliance costs arise in determining which input tax credits can be recovered based on the types of supplies made to the managed funds. As you would appreciate, some of the fund managers who have limited resource in-house would acquire external professional advices from time-to time to ensure that they are not over-claiming any input tax for GST purposes. These processes are often very time and cost consuming.
- 3.4 If management services are treated as fully taxable for GST purposes, any GST incurred on expenses in relation to the fund management services would be fully recoverable. This would eliminate the need of undertaking input tax apportionment calculation in-house or to engage external tax specialists to assist with this process, which further reduce the compliance burden and costs of the fund managers.

***Addresses the competitive disadvantage of outsourcing and the bias to insourcing***

- 3.5 GST exemptions create an undesirable bias for fund managers (predominantly large offshore fund managers who have sufficient resources in-house) to perform all key services in-house for the purposes of removing irrecoverable GST incurred on services procured from third parties. GST exemptions lead to a competitive disadvantage for the fund managers many of whom are domestically owned who may have limited resources and are unable to perform the services in-house. This does not make for good tax policy and creates unfairness within the GST system.
- 3.6 Further, for commercial and regulatory requirement purposes, fund managers are required to outsourced certain activities regardless of the GST costs. Treating management services as fully taxable would allow fund managers to fully recover any GST costs incurred on a wide range of outsourced services, which promotes the advantages of outsourcing and minimises the bias to insourcing. In Australia, the GST law provides additional deductions for a wide range of specific outsourced acquisitions to mimic the effect of insourcing. This is also consistent with Australia and New Zealand financial regulators' view that there is a preference for an outsourced model as it provides for segregation of duties and independent oversight.
- 3.7 By treating the management services as fully taxable, this would eliminate the above bias and promote fairness as well as higher efficiency in allocation of capital decisions.

**4.0 Disadvantages of treating management services supplied to managed funds as fully taxable and how these can be addressed**

- 4.1 If the fund management services are treated as fully taxable for GST purposes, there is a misconception that it would automatically lead to corresponding higher fees and reduced returns for investors. This view is on the basis that the services eventually provided by the managed funds to investors would still be treated as exempt for GST purposes and therefore GST incurred by the



managed funds (i.e. on services received from the fund managers) would not be recoverable and will be passed on to the investors.

- 4.2 We note that the above is not necessarily the case as the fund managers are operating and governed under a robust and transparent regulatory environment. As you would appreciate, the fund managers are required to produce and publish quarterly fund updates (covering the total costs and returns) for use by the public investors. Investors would use these fund updates in their investment decision making process. If 15% GST is charged on the fund management services, to the extent it is irrecoverable, it would form part of the total costs of the funds. Any increase in the costs is likely to reduce the attractiveness of the funds. Therefore, to remain competitive in the market, it is highly unlikely that the fund managers would be able to increase their costs by 15% (and pass this on to the investors).

## **5.0 How policy objectives can be achieved under the preferred approach**

### ***Limits the GST exemption for financial services***

- 5.1 GST is a broad-based tax with few exemptions, with the primary objective of raising tax revenue in a fair and efficient manner with minimal economic distortions. One of the ways in which this policy objective can be met is through limiting the GST exemptions (i.e. the scope of financial services) to highly complex areas with significant practical issues. This is consistent with the discussions in the document “*GST & Financial Services – A government discussion document*” dated October 2002 published by the Policy Advice Division of the Inland Revenue Department.
- 5.2 By treating the management services as fully taxable, it would mean that these services would not be included in the “financial services” net, and this would help in achieving the policy objective of GST. It is pertinent to note that the primary objective of having a GST exemption in place for financial services was due to valuation difficulties. As these issues do not arise for managers and investment managers on the basis that they charge a separate fee for their services (rather than a fee for a bundled mix of services and investment products), there should be no reason to not exclude the services provided by the fund managers from the “financial services” net.

### ***Provides certainty of GST treatment***

- 5.3 The services undertaken by fund managers are extremely complex, resulting in adoption of inconsistent GST treatments within the industry (in respect of both supplies and purchases). Applying GST to fund management services not only addresses and eliminates the obvious shortcomings of the current rules (e.g. insourcing bias, increased tax and compliance costs, etc), but also provides much needed certainty on the GST treatment of the services.
- 5.4 Fundamental to the above proposition is that it would be important to amend (where required) and provide a clearer definition of the “financial services” under the GST Act.
- 5.5 It is important that the definition of the financial services are amended in such a way that it provides a more certain and consistent GST treatment for manager and investment manager services supplied to managed funds. This would also provide clearer guidance for the fund managers to

determine the GST treatment of their products as well as to minimise compliance costs and potential errors.

***Minimises any significant biases that GST may create***

5.6 As discussed in the paragraphs above, by treating the management services as fully taxable would help to directly addresses the following issues:

- ▶ Competitive disadvantage of outsourcing;
- ▶ Biases in capital allocation decisions which promote inefficient investment arrangements.

5.7 We note that the above is consistent with the policy objectives of minimising any significant biases that GST may have created under the current arrangement.

**6.0 GST / VAT treatment in other countries**

6.1 We also note that the approach of treating the management services supplied to managed funds as fully taxable is consistent with the approach adopted by both Australia and Singapore. In Australia and Singapore, GST is applicable at standard rates to all services provided to managed funds. Both these countries however, allow the managed funds to claim back most of the GST costs through a reduced input tax credit mechanism.

**7.0 Conclusion**

7.1 In conclusion, we consider that the management services supplied to the managed funds by the fund managers should be treated as fully taxable considering the various advantages as discussed and that this approach would achieve the policy objectives as discussed in the “GST policy issues – an officials issues paper” dated February 2020.

Thank you in advance for your assistance on this matter and we appreciate your support in considering our comments above.

We would be happy to discuss our submission with you. Please contact me at s 9(2)(a) in first instance in that regard.

Yours faithfully

s 9(2)(a)



Ernst & Young Limited

Chris Gillion  
Policy Manager, Policy and Strategy  
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5 July 2018

Ref: 20341853

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Via email: s 9(2)(a) [@ird.govt.nz](mailto:s 9(2)(a)@ird.govt.nz)

## Submission on Goods and Services Tax – Unit Trusts PUB00277aa and PUB00277bb

Dear Chris

On behalf of the below fund managers we have been engaged to make a joint submission in respect of the following:

- ▶ PUB0277aa “Goods and Services Tax – GST Treatment of Fees Payable to a Manager of a Unit Trust” (“Manager QWBA”); and
- ▶ PUB0277bb “Good and Services Tax – GST Treatment of Outsourced Services in Relation to a Unit Trust (“Outsourced Services QWBA”).

The fund managers are as follows:

- ▶ Devon Funds Management Limited;
- ▶ Pathfinder Asset Management Limited;
- ▶ New Zealand Assets Management Limited; and
- ▶ Mint Asset Management Limited.

Our submission has been prepared to facilitate our meeting with Inland Revenue policy officials and the fund managers on 6 July 2018.

### General comments

The fund managers disagree with certain positions taken in the QWBA's. In particular, the fund managers note that:

- ▶ The GST treatment of investment management services as outlined in the Manager QBWA is incorrect, and should be viewed as a single taxable supply (rather than a supply of financial services);
- ▶ In the event that the management services are not treated as being subject to GST in full, the fund managers should be able to continue to apply the current GST treatment agreed with Inland Revenue (i.e., 10% of management fees should be treated as being subject to GST at the standard rate);
- ▶ In the event that the management services are not treated as being subject to GST in full, appropriate mechanisms should be introduced to provide relief for fund managers who are not vertically integrated, such as the introduction of a reduced input tax credit; and

- ▶ The GST treatment proposed for outsourced management services is contrary to the position taken under the Manager QWBA. Inland Revenue's reasoning fails to acknowledge that the Manager legally remains responsible for these management services, irrespective of whether performed by the Manager or a third party provider. We recommend in the absence of treating investment management services as taxable, that outsourced services should be viewed as the "arranging" of a financial service and follow the same GST treatment.

Our comments are set out in further detail below. All statutory references are to the Goods and Services Tax Act 1985 ("the Act").

## **Detailed comments**

### **1. GST treatment of investment management services**

- 1.1. As outlined in the Manager QWBA, the Inland Revenue summarised a number of activities generally undertaken by managers of unit trusts (paragraph 6). We consider the list of activities listed by the Inland Revenue to be incomplete and that full consideration has not been given to the true nature of the fund managers' services.
- 1.2. We consider the essential nature of the manager's services is the management of the fund, being a management service. The services undertaken by fund managers is extremely complex, and should not be over-simplified. Careful consideration is required as over-simplification will result in an incorrect GST treatment being adopted.
- 1.3. While we agree that, considered in isolation, there are activities carried out by managers that would be financial services for the purposes of the GST Act (such as issuing, redeeming or re-purchasing units), we are of the view that the majority of activities of the fund managers are taxable when considered as a whole.
- 1.4. In particular, we are of the view that the following activities undertaken by fund managers should be viewed as taxable; research on securities and stock position, marketing and advertising of the fund, communication with investors and clients, provision of general market commentary and answering client queries on fund, maintaining legal compliance with securities law, including document preparation and anti-money laundering operations, preparation and distribution of audited accounts and arrangement of the audit, maintenance of a unit register, valuing assets and calculating unit prices, compliance with extensive reporting requirements to the funds trustee and regulator, providing tax advice required by the fund, completing stress testing as required by the Financial Market Authority, reviewing offer materials and meeting with potential fund investors. We note that the above is not a complete list of services carried out by the fund managers.
- 1.5. The essential nature of the above services is a management service, not merely the execution of trades.

### **2. Treating the services as partially subject to GST**

- 2.1 In the event that the fund managers' services cannot be treated as being subject to GST in full, the fund managers consider that a portion of their services should continue to be treated as being subject to GST. The fund managers consider that the current GST treatment (i.e., 10% of the services being treated as being subject to GST) still has some merits.

2.2 However, such GST treatment does not fully address the imbalance between those fund managers that are vertically integrated (and do not suffer GST leakage) and those fund managers that are horizontally integrated (and suffer GST leakage). As discussed below, the fund managers consider that this anomaly needs to be remedied in the GST Act.

### **3. Vertical versus horizontal integration**

3.1. As you will be aware, the current and proposed GST treatment of management fees creates a bias to vertical integration so that GST leakage is eliminated or substantially reduced. For example, by businesses bringing outsourced services in house to remove a GST impost that would otherwise arise. This does not make for good tax policy and creates unfairness within the GST system.

3.2. Changes to address the imbalance and unfairness between vertical and horizontal integration are long overdue. The fund manager's consider that changes should be introduced and there are a variety of options to do this. For example:

(a) The management services could be included in the scope of the zero-rating rules;

(b) A system of reduced input tax credits, similar to the Australian GST approach<sup>1</sup>, could be introduced;

(c) The apportionment rules could be amended to allow fund managers to recover a certain percentage of GST incurred on outsourced services; and

(d) Outsourced services could be treated as exempt from GST (as discussed below).

3.3. Further to point 3.2(b) above, the effect of introducing reduced input tax credits directly addresses the competitive disadvantage of outsourcing and the competitive advantage of insourcing. Rather than imposing tax on an internal supply to mimic the effect of outsourcing, Australian GST law grants additional deductions for outsourced supplies to mimic the effect of insourcing. For a wide range of specified outsourced acquisitions, financial services providers can claim a reduced input tax credit (usually 75% of the input tax).

3.4. Failure to remove this competitive disadvantage using one of the methods outlined above at point 3.2 could ultimately result in a number of managers bringing such services in house. This exact issue was raised in Australia, and was met with strong opposition from financial regulators as there is a preference for an outsourced model as it provides for segregation of duties and independent oversight. Such a view is maintained by New Zealand financial regulators.

### **4. Outsourcing of services**

4.1. In respect of the Outsourced Services QWBA, the fund managers' are of the view that the Inland Revenue have taken a narrow position that certain outsourced services would be considered a taxable supply (that is, there is an assumption no financial services would be provided by the third party).

4.2. While such a position seems contrary to the Manager QWBA (i.e. the services are not considered as part of a broader supply), the proposed GST treatment would result in the GST cost in relation

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<sup>1</sup> See ATO ruling GSTR 2004/1.

to the services being borne by the fund manager as they would not have the ability to pass on the increased costs to the clients.


- 4.3. Assuming that the fund managers are making taxable supplies (as outlined above at paragraph 1.5), the outsourcing of services would be recoverable by the fund managers to the extent they are used in making taxable supplies.
- 4.4. We consider that if the position under the Manager QWBA is maintained that management services is an exempt supply, the services that may be outsourced should also be regarded as supplies of financial services, being the arrangement of financial supplies falling under section 3(1)(l), analogous to the management of a retirement scheme (section 3(1)(j)).
- 4.5. We appreciate that this would require a broad interpretation of the “arranging” of financial supplies. For example, whereby services such as maintenance of a unit register or valuing assets and calculating unit prices should be allowed to be considered to be the arrangement of a financial service.
- 4.6. Fundamental to the above proposition that outsourced services should be viewed as the “arranging” of financial supplies is that the Managers’ remain legally liable for these management services, irrespective of the fact that such services have been outsourced. Adopting the position as outlined by Inland Revenue in the Outsourced Services QWBA fails to recognise the legal realities of such arrangements.

## **5. Conclusion**

- 5.1. In conclusion, we consider that the manager of a fund is supplying management services that do not fit within the definition of a financial supply under the GST Act. The core investment activities carried out by these fund managers, being analysis and research are taxable supplies (i.e. not financial supplies).
- 5.2. The position adopted under the Outsourced Services QWBA is contrary to the Manager QWBA and we recommend that consideration is given as to mechanisms to address the imbalance between vertical and horizontal integration.
- 5.3. In the absence of adopting the position that management services are taxable, we are of the view outsourced services should be viewed as the arranging of a financial service.
- 5.4. We look forward to discussing this submission with you further on 6 July. Do let us know if you have any comments or queries in the interim.

Yours sincerely

s 9(2)(a)



Ernst & Young Limited



7 May 2020

Deputy Commissioner, Policy and Strategy  
Inland Revenue  
PO Box 2198  
Wellington

Via email: [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz)

## **Submission: GST treatment of management services for managed funds**

Pathfinder Asset Management Limited and Alvarium Wealth (NZ) Limited are making this joint submission in relation to potential changes to the GST treatment of manager and investment manager services for managed funds. We refer to “Chapter 7 – Managed Funds” of the “GST policy issues – an officials issues paper” from February 2020.

Thank you for the wide-ranging discussion paper you have prepared on GST for managed funds. We note that the issues considered – including legal, fiscal and commercial – are much broader than previous consultations on this issue. We appreciate this wide-ranging and more commercially focused approach.

We have submitted to you previously on this important and complex GST issue as follows:

- ▶ 5 February 2015 (Pathfinder)
- ▶ 21 December 2015 (Pathfinder)
- ▶ 24 March 2017 (Pathfinder)
- ▶ 5 July 2018 (EY submitted on behalf of Pathfinder and 3 other fund managers)

We agree that the current GST treatment of management services for managed funds is complex and applied inconsistently across the industry. Below we start by summarizing what we see as 5 key policy principles relevant to settling this GST treatment. We then outline our preferred solution and (should that not be accepted) we outline our “fall back preference”. To be clear our fall back is a distant second to our preferred option.

### **Part one – 5 key policy principles**

**1 - Consistent application:** You note that different outcomes can occur for different types of managed fund schemes – for example – ‘standard’ managed funds, retirement schemes and KiwiSaver. We believe that any decision made on GST must be consistent across all of these to avoid unexpected distortions. A single answer should be adopted whether it is for KiwiSaver managed funds, ‘standard’ managed funds or other retirement funds.

**2 – Reduce compliance costs:** We agree that the current GST rules add to compliance costs for managers as you outline in your paragraph 7.8. We believe the outcome chosen should aim to minimize

compliance costs. Reducing compliance costs also highlights the importance of Principle 1 above – treatment must be consistent across ‘standard’ funds, KiwiSaver and other retirement funds.

**3 – No distorted incentives between in-house or out-sourcing:** We agree with your suggestion in para 7.14 that the current GST rules effectively incentivise managers to bring certain tasks in-house. This distortion is undesirable and inequitable – our taxation system should not be incentivizing or rewarding one structure over the other. This distortion has tended to benefit larger fund managers over smaller. Providing a competitive advantage through tax treatment is unfair and should be avoided.

**4 – Neutral (or positive) fiscal effects:** We believe any solution should, at worst, be ‘broadly’ fiscally neutral for tax revenue. Having said that, we should not tolerate an approach regarded as unfair and with high compliance costs simply because we are concerned about possible fiscal effects of the ‘right answer’. If work has been done on the fiscal implications of each option that should be shared with the managed funds industry so we can be mindful of this.

**5 – Basic principle of GST – ‘end user’ should pay:** An underlying principle of the GST legislation is that the end user should ultimately bear the tax. The end user is not the fund manager providing services to a fund – it is the managed fund and its investors. We wonder if there is general agreement that this ‘end user’ principle should apply but concern around passing of GST cost on to investors? If this is the case, then ‘zero-rating’ is by far the best option. (We note your concerns about the fiscal implications but cannot comment as we have not seen any numbers published on the cost this could involve – can you please share that?).

## **Part one – ‘preferred’ and ‘fall back’ options**

**Preferred solution(s):** *Our strong preference is essentially for one of two options - that all management services supplied by investment managers and other fund managers be:*

- ▶ *taxable supplies or*
- ▶ *(based on the discussion under principle 5 above) zero-rated.*

Both the ‘taxable supplies’ and ‘zero-rating’ options have the following benefits:

	<b>Taxable supplies</b>	<b>Zero-rating</b>
<b>Distortions created (ie in-sourcing of services)</b>	Removes distortions that encourage in-sourcing	Removes distortions that encourage in-sourcing
<b>Compliance costs</b>	Reduces compliance costs for managers	Reduces compliance costs for managers
<b>Fiscal drag</b>	Does not create a fiscal drag	No data to draw a conclusion
<b>Managed fund fees</b>	We do not agree with you that the ‘taxable supplies’ option will necessarily lead to higher costs. See our discussion on this below.	Will lead to lower fees (because fund managers getting full recovery of GST on payments - rather than suffering leakage - then they can pass that benefit to investors).



We do not agree that the ‘taxable supplies’ option will necessarily lead to higher costs. We say this because:

- 1) There is significant and long-term downward pressure on fees in the managed funds industry. It is easy for managers to reduce fees, however because of competitive tensions it is rare, if ever, you ever see a manager increase fees.
- 2) The Financial Markets Authority (FMA) oversees fees charged and has a strong stance concerning the need to reduce fees, particularly with KiwiSaver offerings.
- 3) Your suggested 3-year transition period allows managers to keep the status quo in terms of fee structures for a period and effectively “wait and see”. This means that regardless of points 1 and 2 above, there is unlikely to be a swift change in fees with an impact on investors.

**Fall back option:** *If our preferred approach (manager fees being ‘taxable supplies’ or ‘zero rated’) is not adopted then, our second preference (and it is in a distant second place) is for manager fees to be legislated 50% taxable and 50% exempt supplies.*

Currently, some managers charge GST on only 10% of the fee while others charge GST on all of the management fee. Our suggested 50/50 solution has no science behind it (in the same way the widely adopted ‘10% of the fee’ solution has absolutely no science behind it) but 50/50 is an arbitrary half-way house between both positions. 50/50 has the following benefits:

	50% taxable / 50% exempt
<b>Distortions created (ie in-sourcing of services)</b>	Reduces insourcing biases (but not to the same extent as the taxable supplies / zero rating solutions)
<b>Compliance costs</b>	Reduces compliance costs by introducing a higher level of consistency (again, not as good as the taxable supplies / zero rating solutions)
<b>Fiscal drag</b>	Need data
<b>Managed fund fees</b>	Unclear – possible some increase, some have ability to reduce – depends on competitive pressures.

Finally, we reiterate our ‘Principle 1’ above – any solution must be applied consistently across KiwiSaver, other retirement funds and ‘standard’ managed funds. We also refer to our ‘Principle 5’ which underpins the entire GST legislation – that ultimately GST is a ‘end user pays’ tax.

Thanks for the opportunity to submit. If you would like to discuss further please call s 9(2)(a)

Yours faithfully

s 9(2)(a)

14 May 2020

GST policy issues  
C/- Deputy Commissioner, Policy and Strategy  
Inland Revenue Department  
P O Box 2198  
Wellington 2140

By email: [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz)

The Inland Revenue has sought submissions on the GST policy issues paper published in February 2020. We would like to participate, specifically in relation to Chapter 7 – Managed Funds.

The GST issues paper outlines four alternative options for new rules for GST on fund management and investment management services. Our response focuses on three questions that were posed at the conclusion of Chapter 7.

Our response makes reference to our previous submissions made on 23 March 2017 to the Commissioner of the Inland Revenue, where we provided a response to the following draft Questions We've Been Asked (QWBA):

- What is the GST treatment of fees payable by investors to the manager of a unit trust? (QWBA PUB00277aa)
- What is the GST treatment of services for a unit trust that are provided by a third party to the manager of a unit trust? (QWBA PUB00277bb)

Content of these previous submissions will be reiterated in part for this submission.

**Q1. What are the pros, cons or practical issues associated with each of the policy options? How well would they achieve the policy objectives?**

Option 1: Fund manager and investment manager services are fully taxable (15% GST):

The most significant benefit is clarity and the removal of the complexity of the current GST rules. GST compliance is also simplified as fund managers are allowed to claim input credits for GST charged on external costs.

The most significant disadvantage is that it would impose a higher unrecoverable GST cost on funds, increasing fees and reducing after-tax returns for retail investors. The FMA have been vocal about fund managers providing value for money for clients. An increase in fees with no increase in value provided to the client contradicts this objective.

This option achieves the GST policy objectives of limiting the GST exemption for financial services and providing certainty of GST treatment. However, transitioning from current practice would result in additional fees to investors with the addition of GST. Our understanding is that a majority of the industry apply the existing FSC agreement with the Inland Revenue, treating 10% of fund management and investment services as taxable. This would therefore be a considerable change to the industry status quo.

Furthermore, while this option reduces in-house bias, it would create biases towards investing through retirement funds rather other type of managed funds (assuming the GST exemption for managers of a retirement scheme is retained).

Option 2: Fund manager and investment manager services are exempt financial services:

This option is consistent with the Commissioner's stance in the draft QWBA PUB00277aa. It was determined that fees payable to the manager of a unit trust are not subject to GST, as they are consideration for an exempt supply under s 14(1)(a) of the GST Act. This option would extend the financial services exemption to all fund manager services.

Like option 1, option 2 provides clarity and removes the complexity of the GST rules by applying a blanket exemption. Option 2 reduces the unrecoverable GST cost on funds, reducing fees and increasing the after-tax return for retail investors. Furthermore, the bias of investing through retirement funds rather than other types of managed funds is removed.

The most significant disadvantage is that it comes at a cost to the fund manager, as they would no longer be able to recover any input GST. However, as previously submitted in our response to QWBA PUB00277aa, the simplicity for investors, aligning the GST treatment between retirement funds and other types of managed funds, and reducing the cost to investors is important, and outweighs the cost to us.

Although this option would increase in-house bias, as previously submitted in our response to QWBA PUB00277bb, we believe that administrative services such as fund accounting, unit pricing and record keeping should be exempt supplies, as they are reasonably incidental and necessary for the supply of financial services by the manager, irrespective of whether these services are performed in-house or outsourced by the fund manager. This would effectively remove the in-house bias.

This option achieves the GST policy objectives of providing certainty of GST treatment, with low transition costs compared to current commercial practice, as the majority of the industry would only require a 10% adjustment in GST treatment. In-house bias would be minimal, provided that outsourced administrative services were also considered exempt. However, this option would broaden the GST exemption on financial services.

Option 3: Deem a certain percentage of fund manager and investment manager services to be taxable (and the remainder exempt):

The most significant benefit is that it aligns with the majority industry practice, being the existing FSC agreement with the Inland Revenue.

The most significant disadvantage is that this does not address the complexity of the current GST rules. Each fund manager is unique, and there would be no general consensus from the industry as to what ratio to legislate going forward.

Furthermore, this option would increase GST compliance costs. We expect that the Inland Revenue would require guidance from the industry to determine the appropriate ratio to legislate. Any proposal would require detailed analysis. This requires time and effort, and may result in an outcome which is quite different to current practice, notwithstanding a variety of answers from the industry that do not provide a definitive solution. As the industry continuously evolves, it is likely that this exercise would need to be revisited on a regular basis to ensure the legislated ratio remains appropriate.

Provided that the legislated ratio is consistent with the 10:90 taxable to exempt arrangement between the FSC and Inland Revenue, this option would have the lowest transition cost compared to other options. However, the complexity of the GST rules still remains, and there is the potential for in-house bias depending on what ratio is legislated. In summary, a number of existing issues with the GST policy objectives still persist after this option is implemented.

Option 4: Zero rated supply, or a reduced input tax credit (RITC) mechanism

Zero rating has the greatest benefit of all the options. It provides clarity, removes the complexity of GST treatment, reduces the cost for retail investors and allows fund managers to recover 100% of input GST charged on external costs, thereby eliminating in-house bias.

An RITC would address insource bias, however, as noted in the GST issues paper, there will be added complexity as to the calculation of the percentage of the RITC allowable.

The main disadvantage for these options is that there would be some transition costs, as this option represents a considerable change to the status quo. Furthermore, the under-taxing of manager and investment manager services may result in the Government compensating through increased taxation on other fund manager activities.

**Q2. What types of manager and investment manager services should the proposed policy or law change apply to? What is the clearest way to define the relevant services?**

Our preference would be for the change in law to reflect either option 2 (exempt supplies) or option 4 (zero rated/ RITC mechanism). From a GST policy objective standpoint, these options address many of the issues associated with the current GST rules, as detailed in our answer to the previous question. Furthermore, they result in a reduction to fees and increased after tax returns for retail investors, aligning with the objectives of the FMA.

With option 2, the financial service exemption would apply to all services provided by the fund manager directly, as well as administrative services outsourced by the fund manager to third parties which are reasonably incidental and necessary for the supply of financial services by the fund manager. Examples of these would be fund accounting, unit pricing and record keeping.

For option 4, similar to above, all services offered by fund managers would be zero rated as well as administrative services outsourced by the fund manager to third parties, provided they were reasonable incidental and necessary to the supply of financial services by the fund manager.


**Q3. If the law was changed, what transitional issues could arise and what measures could be implemented to enable a smooth transition to the new law?**

If the law were changed, a transitional period should be introduced, allowing fund managers and their outsourced service providers to apply their existing GST arrangements, until their necessary processes, structures and contracts were updated to allow full compliance with the new law. During this time, the Inland Revenue should undertake workshops with the industry to answer frequently asked questions about the new law. In addition to this, personalised communication between the Inland Revenue, fund managers and outsourced service providers will address specific company and process issues with implementing the new law.

We hope this feedback is valuable for your consideration of the GST issues relating to fund manager and investment manager services.

On behalf of Fisher Funds Management Limited,

s 9(2)(a)





15 May 2020

GST issues paper  
C/- David Carrigan  
Deputy Commissioner, Policy and Strategy  
Inland Revenue Department  
P O Box 2198  
**WELLINGTON 6140**

Dear David

### **GST POLICY ISSUES: AN OFFICIALS' ISSUES PAPER**

The Corporate Taxpayers Group ("the Group") is writing to submit on the GST policy issues paper ("the paper") as many of the topics raised impact members of the Group.

The Group appreciates the opportunity to comment and to raise some wider issues with the Goods and Services Tax ("GST") regime in New Zealand. The Group appreciates the approach taken by Officials to allow all submitters an extended time to prepare submissions in light of the business disruption caused by COVID-19.

The Group sets out below a table summarising the issues and options raised by the paper and our response to each.

### **THE GST REGIME**

The Group supports continued policy development in response to changing business practices and it is pleasing to see a number of proposals in the paper seek to modernise the GST regime, simplify complex areas and remove unnecessary compliance costs. However, the Goods and Services Tax Act 1985 ("the Act") was written for a business setting unrecognisable to the one operating today. This has resulted in many areas of the Act that do not achieve the original policy intent or do not fit with normal business practice, well beyond those covered in this submission.

The Group considers that the current Act consists of overly long and complex provisions with extensive cross-referencing which is difficult to understand and comply with. There are many areas where the current Act does not achieve the correct outcome, only some of which are covered in this paper. The Group considers a re-write of the Act using simple language, with today's business environment in mind, would be more beneficial than continued re-working of the existing Act which is over 30 years old.

### **ABOUT THE GROUP – INFORMED, PRINCIPLED, PRACTICAL**

#### *About the Group*

The Corporate Taxpayers Group is an organisation of major New Zealand companies that works with key Inland Revenue and Treasury officials to achieve positive changes to tax in New Zealand.

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#### **Contact the CTG:**

c/o s 9(2)(a) Deloitte  
PO Box 1990  
Wellington 6140, New Zealand  
DDI: s 9(2)(a)  
Email

**We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.**



The objective of the Group is to pursue the principled interests of its members in the tax sphere. The practical experience of Group members enables it to encapsulate general economic concepts into principles that guide and underpin its submissions.

The Group believes that a good tax system for New Zealand should be built around the following principles:

- *High certainty and low business risk:* For the corporate sector, tax is not just a cost of doing business but is also a very significant risk. Funds are raised, staff hired, and investments made on the basis of expected returns to corporate shareholders / owners. If tax rules increase business risk by creating uncertain or unexpected tax outcomes then the rate of return on investment has to be higher to compensate for this. Higher required rates of return mean less investment and fewer jobs, to the detriment of the economy. To lower business risks caused by the tax system, tax rules need to be as certain as possible and they need to be administered and interpreted by the Inland Revenue consistently and speedily. Having a high level of certainty over the medium to long term is of high importance to the Group.
- *Low compliance costs:* Compliance costs imposed by the tax system are an economic cost. Those resources would be better employed creating jobs and raising the wealth of New Zealand.
- *Positive contribution:* The tax system plays a significant role in society and has the ability to contribute to the overall welfare and wellbeing of New Zealand and New Zealanders. Any changes to the tax system should focus on building and utilising the collective human, social, natural and financial capital of New Zealand, and should also make a positive contribution to New Zealand.
- *International competitiveness, especially with Australia:* Taxes are a significant cost of doing business. The higher those costs are in New Zealand relative to other countries, the higher the relative costs of doing business in New Zealand. That flows through to less investment, fewer jobs and lower wealth. New Zealand's tax system plays a critical role in our competitive position with our major trading partners and competitors. In addition to attracting foreign investment, a competitive tax system is one that ensures that New Zealand is attractive as a base for outbound investment. While New Zealand businesses compete with the rest of the world for investment funding, markets and skilled workers, Australia is our nearest and most significant competitor. For that reason the Group considers that the New Zealand tax system should set as a minimum benchmark, a system that provides a business environment at least as good as that which exists in competing countries, especially Australia.

The above principles are central to the way the Group judges tax policy issues.

It is very important to the Group that Inland Revenue uses its resources appropriately and does not impose excessive compliance costs on business by over complicating parts of legislation that are unable to be interpreted or applied in practice.

While the Group supports the majority of the proposals set out in the paper, it is noted that the Group advocates for simple and understandable law, and that where changes to formulas or application of the law as proposed it should be done so with the concept of simplicity in mind.

## EXECUTIVE SUMMARY

The position of the group can be summarised per the below:

Not in scope



Not in scope

- The Group supports option number four for the GST treatment of managed funds.

Not in scope

We provide further detail on the above and other submission points in the attached appendix.

For your information, the members of the Corporate Taxpayers Group are:

- |   |   |
|---|---|
| 1. AIA New Zealand Limited                | 23. Methanex New Zealand Limited            |
| 2. Air New Zealand Limited                | 24. New Zealand Racing Board                |
| 3. Airways Corporation of New Zealand     | 25. New Zealand Steel Limited               |
| 4. AMP Life Limited                       | 26. New Zealand Superannuation Fund         |
| 5. ANZ Bank New Zealand Limited           | 27. Oji Fibre Solutions (NZ) Limited        |
| 6. ASB Bank Limited                       | 28. OMV New Zealand Limited                 |
| 7. Auckland International Airport Limited | 29. Pacific Aluminium (New Zealand) Limited |
| 8. Bank of New Zealand                    | 30. Powerco Limited                         |
| 9. Chorus Limited                         | 31. SkyCity Entertainment Group Limited     |
| 10. Contact Energy Limited                | 32. Sky Network Television Limited          |
| 11. Downer New Zealand Limited            | 33. Spark New Zealand Limited               |
| 12. First Gas Limited                     | 34. Summerset Group Holdings Limited        |
| 13. Fisher & Paykel Appliances Limited    | 35. Suncorp New Zealand                     |
| 14. Fisher & Paykel Healthcare Limited    | 36. T & G Global Limited                    |
| 15. Fletcher Building Limited             | 37. The Todd Corporation Limited            |
| 16. Fonterra Cooperative Group Limited    | 38. Vodafone New Zealand Limited            |
| 17. Genesis Energy Limited                | 39. Watercare Services Limited              |
| 18. IAG New Zealand Limited               | 40. Westpac New Zealand Limited             |
| 19. Infratil Limited                      | 41. WSP New Zealand Limited                 |
| 20. Kiwibank Limited                      | 42. Xero Limited                            |
| 21. Lion Pty Limited                      | 43. Z Energy Limited                        |
| 22. Meridian Energy Limited               | 44. ZESPRI International Limited            |

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

Yours sincerely

s 9(2)(a)



**For the Corporate Taxpayers Group**



**APPENDIX**

Not in scope

6. CHAPTER SEVEN: MANAGED FUNDS .....12

Not in scope





Not in scope

## 6. CHAPTER SEVEN: MANAGED FUNDS

Issue: The GST treatment of different types of management services supplied to managed funds is complex and applies inconsistently.

Proposal	CTG Comment
Option 1: All management services supplied by investment managers and other fund managers are taxable supplies.	The Group supports New Zealand's Broad Based Low Rate system and the fact that New Zealand's GST system is effective through its broad rules with limited exceptions.
Option Two: All management services supplied by investment managers and other fund managers are exempt.	The tax system should also be a neutral factor in investment decisions where possible and provide taxpayers with certainty and clarity. These principles should be applied to GST and managed funds.
Option Three: Deem a percentage to be exempt (and the remainder taxable).	However, the Group notes that GST on managed funds is a particularly complex issue due to the various number of fund structures that will give different outcomes under the current GST on managed fund rules and under the proposed options.
Option Four: Zero-rating or a reduced input tax credit mechanism.	<p>The Group submits that great care should be taken when imposing costs that would make their way to the fund (limiting input tax credits and charging GST on all managed fund services) as the New Zealand economy moves into a "post COVID-19" period where saving and investing more generally will become difficult.</p> <p>Overall the Group prefers Option Four, zero-rating or a reduced input tax credit mechanism. This would not be seen as an expansion to zero-rating, but reducing the compliance cost of managed fund providers. This would also have the effect to reduce the cost of the service provided to customers, which the Group considers an important matter given the current economic environment and the reduced capability New Zealanders will have to save and invest. As noted above given the complexity of this issue and the difficulty in finding the</p>



	<p>correct treatment across different fund structures, any changes should be carefully considered and there should be an appropriate transition period.</p> <p>In addition the Group notes the zero rated option should be progressed as it creates neutrality between GST on management fees for superannuation funds, retirement funds and other managed funds. This option also removes the bias between insourcing and outsourcing of services for fund managers as it would allow inputs to be claimed for outsourced services.</p>
Changes to apply prospectively but with grandparenting of existing contracts for a period (for example, three years) to ease adjustment costs and to enable new contracts to be negotiated.	The Group supports this proposal. The application date of any changes needs to allow sufficient time for the industry to adjust / amend its processes and contracts for the new position (the paper suggests a three year grandparenting period).
Defining the relevant management and investment management services.	The Group agrees with this proposal as this definition will likely be required regardless of the option (as listed above) that is taken. The Group notes that the definitions should be broad based and simple, written in plain English.
No change to the GST treatment of other services provided to managed funds such as accounting, administrative or registry services.	The Group agrees with this proposal.



**Private and confidential**

Deputy Commissioner  
Policy and Strategy  
Inland Revenue  
PO Box 2198  
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sent via email: [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz)

15 May 2020

***Submission on the officials' issues paper - "GST Policy Issues"***


Dear Deputy Commissioner

Thank you for the opportunity to comment on the officials' issues paper, *GST Policy Issues* (**the issues paper**).

The issues paper contains a number of proposed amendments to the Goods and Services Tax Act 1985 (**GST Act**) to reflect changing business practices, advances in technology, and developments in GST case law. As a general comment, we support the continued maintenance and development of GST law and policy to keep pace with these changes. The proposals contained in the issues paper touch on many areas of current uncertainty in the law and address unintended gaps in the current law.

We have summarised our submissions in Appendix A. We provide our more detailed comments in relation to the proposals contained in the issues paper below.

Not in scope

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Not in scope

## **Chapter 7: Managed funds**

We support the proposal to provide a more certain and consistent GST treatment for manager and investment manager services supplied to managed funds.

Ultimately the GST costs are borne by the retail investors and it is important that the rules do not create distortions between the fees charged by different managers as a result of their particular operating model.

### ***What are the pros, cons or practical issues associated with each of the policy options? How well would they achieve the policy objectives?***

#### *Making all management services supplied by investment managers and other fund managers taxable supplies*

This option is fundamentally inconsistent with the GST exclusion for financial services and would result in increased fees for retail investors, which is undesirable.

#### *Exempting all management services supplied by investment managers and other fund managers*

This option addresses the current bias between retirement savings schemes and other non-retirement funds. However, it creates a bias against funds that outsource significant parts of their management services.

One solution could be to exempt all management services but allow managers that outsource the majority of their services (over a set threshold) to elect to zero rate their management fees, mitigating the additional GST cost suffered by those predominantly outsourced managers.

#### *Legislate that managers and investment managers are deemed to have a certain percentage of taxable (subject to GST at 15%) and exempt supplies*

This is closest to the current practice applied by a significant portion of the industry which applies the existing agreement between the Financial Services Council (FSC) and Inland Revenue. The principal difficulty is determining the correct proportion of taxable and non-taxable supplies. Given operating model differences within the sector this percentage will then seldom result in the correct apportionment for individual fund managers.



*Zero-rating or a reduced input tax credit mechanism*

Zero rating of all fund management services (including retirement schemes) would achieve two important policy objectives, namely minimising costs to retain investors and creating a level playing field within the funds management sector.

It also provides certainty and the lowest compliance burden of all of the options proposed.

A reduced input tax credit mechanism is likely to add significant additional compliance costs and as noted in the issues paper it is difficult to determine the appropriate percentage of recoverable GST (similar to the partial exemption option).

***What types of manager and investment manager services should the proposed policy or law change apply to? What is the clearest way to define the relevant services?***

Whether services are investment management services or some other class of administration service is a factual question and will vary depending on the legal agreements and nature of the services provided.

***If the law was changed, what transitional issues could arise and what measures could be implemented to enable a smooth transition to the new law?***

We agree with the proposal to allow grandparenting for existing contracts to ease adjustment costs and enable new contracts to be negotiated. The grandparenting arrangement should be broad enough to take into account the foreseen delays in negotiating new contracts (i.e. some existing contracts may need to be extended under the old rules to allow time for commercial negotiations).

Not in scope





Not in scope



We trust our submission has been helpful. We would be happy to discuss our submission with you in further detail if that would be helpful. If you have any questions, please contact s 9(2)(a) or me.


Yours sincerely





**Appendix A: Summary of submissions**

Not in scope

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Not in scope

Chapter 7 - Managed funds	<ul style="list-style-type: none"><li>• We support the proposal to provide a more certain and consistent GST treatment for manager and investment manager services supplied to managed funds.</li></ul>
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Not in scope





s 9(2)(a)

Mercer (N.Z.) Limited

PO Box 2897

Wellington 6140

Level 2

20 Customhouse Quay

Wellington 6011

11<sup>th</sup> May 2020

s 9(2)(a)

Mr David Carrigan  
Deputy Commissioner, Policy & Strategy  
Inland Revenue Department  
P O Box 2198  
Wellington 6140

Dear David

### **Submission on GST policy issues paper**

On behalf of UniSaver Limited I welcome the opportunity to make a submission on the recently released GST policy issues paper. This submission focusses on the options set out in Chapter 7 (Managed Funds) with respect to the GST treatment of services provided to managed funds by fund and investment managers.

UniSaver is an employer-sponsored registered superannuation scheme established in 1993. Membership of the scheme is available to all permanent and eligible fixed-term employees of participating New Zealand universities and stands at s 9(2)(b)(ii) as at 31 March 2020. Members' balances stood at s 9(2)(b)(ii) at that date. The scheme is the second largest restricted workplace scheme in New Zealand.

UniSaver is of the view that a change to the GST regime resulting in fund and investment managers' services provided to managed funds being taxable supplies would be undesirable and, given the impact on net investment returns, would run contrary to the government's ongoing drive to encourage saving for retirement at the level of the individual level.


Specifically, concern arises from the proposed option set out in paragraphs 7.23 to 7.27: “Making all management services supplied by investment managers and other fund managers taxable supplies” and paragraph 7.26 expresses the concern explicitly. Applying GST to all management services supplied by fund and investment managers would indeed result in “higher fees and reduced after tax returns” for the scheme’s members as the UniSaver board, on the basis of good governance and sound practice, outsources management of the investment of the scheme to a professional funds manager. Put simply and directly, the scheme has no structures whereby UniSaver can pass GST on – the additional tax burden on would stop with scheme members.

UniSaver submits that a zero-rating approach would be the most appropriate GST treatment of services provided to managed funds by fund and investment managers, such that investors do not bear a related GST cost.

Although UniSaver prefers to see the zero-rating option implemented, UniSaver submits that the alternative outcome should be that fund and investment managers’ services are exempted from GST. That said, given that a GST-exempt approach is likely to see an increase in fees (and, therefore, a reduction in investment returns), this is not considered an ideal outcome.

Kind regards,

s 9(2)(a)

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**MISS Scheme**

PO Box 2897, Wellington 6140, NZ

Phone: (04) 819 2638

15 May 2020

GST Policy Issues  
C/- Deputy Commissioner, Policy & Strategy  
Inland Revenue Department  
P O Box 2198  
**WELLINGTON 6140**

By email to [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz)

Dear Deputy Commissioner

**Submission on GST policy issues**

The Trustees of the MISS Scheme welcome the opportunity to submit to you our comments on the GST policy issues paper that was released in February 2020. Our submission focusses on the options set out in Chapter 7 (Managed Funds) with respect to the GST treatment of services provided to managed funds (such as the MISS Scheme) by fund and investment managers.

The MISS Scheme is an employer-sponsored, restricted workplace savings scheme established on 31 July 1991. The MISS Scheme's membership consists of employees who are engaged to work for companies which are members of the Meat Industry Association of New Zealand and other employers within the meat industry of New Zealand. There were about s 9(2)(b)(ii) members in the MISS Scheme as at 31 March 2020, with aggregate balances of around s 9(2)(b)(ii).

The MISS Scheme submits that the preferred outcome is that services provided to managed funds such as the MISS Scheme by fund and investment managers be zero-rated for GST purposes. In that way, an investor saving for their retirement does not bear a related GST cost. We consider that this is particularly important given the current, and likely long-term, impact that the Covid-19 pandemic has had on retirement savings. Zero-rating the fund and investment managers' services would also be align with the government's continuing initiatives for encouraging individuals to save for their retirement.

While zero-rating the services in question is the preferred outcome, the MISS Scheme's preferred alternative would be to exempt fund and investment managers' services from GST. However, on the basis that that approach is likely to mean that fund and investment managers will increase their fees, which adversely affects investors' retirement savings, the MISS Scheme does not consider a GST-exempt outcome to be ideal.

Of particular concern to the Trustees is the option of making the management services provided by fund and investment managers taxable supplies for GST purposes. In particular, given the nature of the MISS Scheme, it is unable to register for GST. Further, for governance purposes, the MISS Scheme outsources the management services that would be subject to GST if a fully taxable approach were adopted. As such, and as set out in paragraph 7.26 of the paper, members will in effect be impacted with "higher fees and reduced after-tax returns". On that basis, we submit that treating its services as taxable supplies is clearly inconsistent with encouraging individuals to save for their retirement and is undesirable given the adverse impact that it would have on investment returns and members' retirement savings.

Kind regards,

s 9(2)(a)



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GST policy issues  
C/- Deputy Commissioner, Policy and Strategy  
Inland Revenue Department  
PO Box 2198  
Wellington 6140

19 May 2020

## **Submissions on GST Policy Issues Paper**

Dear David

We refer to **GST policy issues – An officials’ issues paper** (“the paper”). Thank you for the opportunity to comment on the paper and for agreeing to an extension on the comment deadline.

We set out a summary of our key submissions below, with further high-level comments in the Appendix. We would be happy to have a more detailed discussion with you on any matters raised in our submission.


Legislative references are to the Goods and Services Tax Act 1985 (“GST Act”) unless otherwise stated and chapter references are to the paper unless otherwise stated.

### **Summary of main submission points**

Not in scope

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### ***Chapter 7 – Managed funds***

- ▶ The GST treatment for manager and investment manager services supplied to managed funds is complex and potentially in need of reform.
- ▶ Any potential changes should be:
  - ▶ Developed in consultation with the industry and other interested parties and subject to further public consultation.
  - ▶ Prospective in nature with an appropriate transition period and safeguard for prior periods.

Not in scope





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## Appendix: Further high-level comments

### 1 Overall comments


1.1 We welcome the consideration of technical tax policy issues associated with the current GST regime. While we support many of the suggestions in the paper, in some areas further work is required before potential changes can be developed.

1.2 In addition, some of the changes need to go further than suggested in the paper in order to simplify the rules, reduce compliance costs for taxpayers and bring the rules in line with modern business practices.

1.3 We set out our high-level comments below.

Not in scope


Not in scope



## **7 Chapter 7 – Managed funds**

- 7.1 We agree the GST treatment for manager and investment manager services supplied to managed funds is complex and potentially in need of reform. We recognise the difficulty of reform in this area and care will need to be taken to ensure any changes are easy to understand and address the current complexity.
- 7.2 Any potential changes in this area should be developed in consultation with the industry and other interested parties and subject to further public consultation. Further, any legislative changes should be prospective in nature with an appropriate transition period and safeguard for prior periods.

Not in scope





**Building a better  
working world**

We would be happy to discuss our submission with you. Please contact s 9(2)(a) [redacted] in the first instance in that regard.

Yours sincerely,

s 9(2)(a) [redacted]

Ernst & Young Limited

Ernst & Young Limited





**Submission to Inland Revenue Department**

**ON**

**GST Policy issues**

*An officials' issues paper*

## Introduction

1. This Submission is from Trustee Corporations Association of New Zealand Inc ("TCA" or "the Association") in response to the issues paper: "GST policy issues, prepared by Policy and Strategy, Inland Revenue.
2. TCA supports the Inland Revenue's initiative to undertake the review, and considers it is particularly important in light of the global COVID-19 pandemic and the evolving nature of the financial markets, in particular the Managed Funds sector. TCA considers it is good practice to review all regulatory frameworks from time to time to ensure they remain fit for purpose.
3. TCA would be happy to meet with Inland Revenue to discuss any aspect of this submission. We can be contacted at:

Trustee Corporations Association of New Zealand Inc

Level 6

191 Queen Street

Auckland

Attn: s 9(2)(a)

or

PO Box 10 133

Wellington 6143

Attn: s 9(2)(a)

Ph:

Ema

## About TCA

4. TCA is a long-established association representing licenced Statutory Supervisors which supervise Managed Funds. The Members of TCA are: Public Trust, Trustees Executors Limited, The New Zealand Guardian Trust Company Limited and Covenant Trustee Services Limited. Anchorage Trustee Services Limited is an associate Member of TCA (**TCA Members**).
5. TCA maintains relationships with government ministries, regulatory bodies and financial sector groups.
6. TCA Members also provide prudential supervision for a wide range of investment products and financial arrangements through legal structures appropriate for the particular product offered. In certain instances, Managed Investment Schemes and Debt Issuers must appoint a supervisor to meet regulatory requirements before an offer of a financial product can be made to the market. As at 30 June 2019, TCA Members supervised funds in excess of s 9(2)(b)(ii)
7. All TCA Members are licensed under section 16(1) of the Financial Markets Supervisors Act 2011 to provide prudential supervision of a wide range of investment products and financial arrangements. All licence holders are Members of TCA.

## TCA submission

### 8. Overview

The GST Issues Paper, Chapter 7, discusses policy options for changing the GST treatment of manager and investment manager services supplied to managed funds. It outlines the differing GST treatments currently adopted throughout the industry and seeks submissions on four possible GST treatments from industry participants.

The Issues Paper also highlights the policy objectives to be taken into consideration when determining the most appropriate GST treatment for services supplied to managed funds, being:

- Limiting the GST exemption for financial services;
- Minimising any significant biases that GST may create;
- Providing certainty of GST treatment; and
- Minimising adjustment costs compared to current commercial practices.

As noted above, TCA members welcome the initiative to undertake the review of the GST treatment of services provided to managed funds. However, in our view, there is a key element of this area of the industry that is not included in the GST Issues Paper and we now submit that it be considered and properly addressed.

While the Issues Paper focuses on the GST treatment of services provided by investment managers and other fund managers, in practice, such services are often outsourced to a third party. The GST treatment for services provided to a managed fund (in particular a retirement scheme) by a third party must also be addressed if the policy objectives of the review are to be met.

Specifically, the issue of the GST treatment of registry services (which includes unit pricing services, being a management requirement of a unitised scheme) provided to retirement schemes should be addressed at an industry level and included in the current review of GST treatment for managed funds. Registry services provided to retirement schemes have largely been interpreted by the industry as being exempt under s3(1)(j) of the GST Act, but to date this has not been able to be agreed with Inland Revenue.

TCA Members have been corresponding on this matter with Inland Revenue for the past decade. Inland Revenue's view regarding the GST treatment of these services is that it is exempt when performed inhouse but taxable when outsourced to a third party. The Inland Revenue's interpretation of joining the definition of "manager" to that of "management" is inappropriate in an environment where outsourced services are becoming more prevalent. The GST treatment of a service should be determined by the nature of that service, not by the entity structure for delivery of that service.

Further to the policy objectives noted in the Issues Paper, the financial impact on investors, retirement savings for New Zealanders and consistency of application of GST rules should also be taken into account when determining the most appropriate GST treatment of services provided to managed funds. There is no denying the immediate and ongoing impacts faced by investors as a result of the global COVID-19 pandemic and the potential impact of an additional GST impost on savings cannot be ignored.

## 9. GST treatment of registry services provided to a retirement scheme

TCA submits that the phrase “management of a retirement scheme” contained in section 3(1)(j) of the Goods and Services Act 1985 (“GST Act”) be applied consistently whether “management of a retirement scheme” is provided “in-house” or outsourced to an external provider.

We note and emphasise that, in practice, there is no material difference in the management function provided depending on whether it is an “in-house” or outsourced management provider.

In practice, registry services, such as unit pricing services (which is required for the management of a unitised scheme), is often outsourced to a third party rather than provided by the manager of a retirement scheme. Industry participants have largely interpreted and treated these services as being GST exempt under section 3(1)(j) of the GST Act.

### 9.1 Meaning of the term “financial services”

As part of the review undertaken for the items noted in the GST Issues Paper, Chapter 7, we submit that the interpretation of the term “financial services” be considered, with particular emphasis on whether it is the policy intent that the application of this definition differs based on whether that service is insourced or outsourced.

In particular, we note that unit pricing services (which is required for the management of a unitised scheme) could well qualify for exemption under certain paragraphs of section 3. We provide our comments below:

Meaning of the term “financial services”	TCA comment
1 For the purposes of this Act, the term <b>financial services</b> means any 1 or more of the following activities:	
a) the exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise):	<i>Inland Revenue has implied this section is only applicable to banks.</i>
d) The issue, allotment, or transfer of ownership of an equity security or participatory security:	<i>There is a custodial element of registry which encompasses the transfer of ownership of an equity and could fall within the requirement of this paragraph.</i>
g) the renewal or variation of a debt security, equity security, participatory security, or credit contract:	<i>Unit pricing could be interpreted to fall as a variation to equity security.</i>
j) the provision, or transfer of ownership, of an interest in a retirement scheme, or the	<i>The current reliance for treating registry services as exempt is based on this paragraph.</i>

management of a retirement scheme:	
ka) the payment or collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security, equity security, participatory security, credit contract, contract of life insurance, retirement scheme, financial option, or futures contract:	<i>There is a custodial element of registry which encompasses the requirements of this paragraph.</i>
l) Agreeing to do, or arranging, any of the activities specified in paragraphs (a) to (ka), other than advising thereon:	<i>In our view, this subparagraph could serve to extend the application of subsection 3(1) of the Act to outsourced third party providers of the services covered by paragraphs (a) to (ka) of section 3(1).</i>

## 9.2 Meaning of “management of a retirement scheme”

Based on our correspondences with Inland Revenue over the past decade, we understand that Inland Revenue interprets “management” as the ability to “control, supervise and oversee the retirement scheme”. Thus, it is only the Trustee (Statutory Supervisor) and fund manager that can “manage” a retirement scheme. On this basis, the management services provided by these entities (as well as other incidental “non-management” tasks performed by the Trustee and fund manager) would be exempt from GST under section 3(1)(j) of the GST Act. However, where these other tasks are performed by a person other than the Trustee and/or the fund manager, the services are not considered to be “management of a retirement scheme” and, accordingly as considered by the IR, fully taxable.

TCA considers that “management” should be determined by reference to the **nature** of the activities that are fundamental to the operation of a retirement scheme rather than by the provider of those services. An activity is fundamental where the retirement scheme cannot function without that activity or its output.

While TCA acknowledges that not all activities carried out in respect of a retirement scheme can constitute “management”, we consider that the position taken by Inland Revenue is too narrowly focussed in light of current industry practice. The full catalogue of discussions to date between TCA and Inland Revenue in respect of this matter is available upon request.

## 10. Consistency in interpretation

Inland Revenue has previously advised that the activities of a third party who supplies registry or fund accounting and unit pricing services are not management of a retirement scheme and, therefore, do not fall within the ambit of section 3(1)(j) of the GST Act. However, we counter this as section 3(1)(j) of the GST Act also encompasses “the provision, or transfer of ownership, of an interest in a retirement scheme” which is a fundamental element of a registry service and unit pricing activity. Additional registry services also include the elements of sections 3(1)(b) and 3(1)(ka) of the GST Act.

We note that Inland Revenue's view to date has been that the supply of custodial services by a third party is a financial service under section 3(1)(c), (d), (ka) of the GST Act and, therefore, exempt from GST.

In our view, this creates a mismatch in interpretation of the "management" of a retirement scheme as various functions that are fundamental to the operation of the retirement scheme have differing treatment for GST purposes. Further, this creates an "in-source bias" as the GST treatment differs where these services are provided by third parties. Uncertainty regarding the GST treatment and biases created by GST are two of the key policy objectives driving the GST review of this area of industry.

## **11. Policy intent**

TCA understands the policy intent of section 3(1)(j) of the GST Act was to align the treatment of savings through life insurance and retirement vehicles. At the outset of the GST regime in New Zealand, industry practice meant that it was highly likely a single party would perform all activities necessary for the management of a retirement scheme. In our view, this does not mean that the policy intent was to necessarily exclude activities, but rather to treat these fundamental activities as included in "management of a retirement scheme" because it would not matter who performs the activity. However, as time has passed and the way savings vehicles are regulated, in practice, not all services necessary for the management of a retirement scheme are performed by the scheme's manager or Trustee. Instead, for example, services such as registry are outsourced to third parties. Through our correspondence with Inland Revenue, they have advised that in this instance, the services do not constitute "management of a retirement scheme" and, therefore, must be treated as taxable. This is inconsistent with the policy intent of removing an in-source bias.

We consider that it is illogical that management services provided by parties other than the Trustee and fund manager do not constitute "management of a retirement scheme" simply because these tasks are no longer performed by a single party (i.e. the manager of that scheme). Further, it is incorrect to conclude that it is only the manager of a scheme who can perform activities that constitute "management of a retirement scheme". We submit that it is preferable to have a consistent interpretation of "management" where it is irrelevant who performs the activity for the retirement scheme.

## **12. Adverse impact on retirement savings**

Government policy is to encourage national savings, and this has been supported through the introduction of savings vehicles like KiwiSaver and reduction of compliance costs associated with long term investments.

TCA notes that the inconsistent GST treatment of "management of a superannuation scheme" when in-sourced vs outsourced to a third party currently has, and will continue to have, a significant impact on the retirement savings sector. Based on Inland Revenue's current interpretation of the term "management of a retirement scheme" under section 3(1)(j) of the GST Act, the GST treatment is not consistent for all service providers. TCA Members note that from a service provider perspective, the GST treatment is irrelevant (i.e. whether it be exempt or taxable), but rather it is the inconsistency amongst industry participants that:

- creates a bias in the market; and

— results in an increase cost of savings for investors on the basis that the GST impost is passed on to investors.


Through the differing application of GST on services provided to retirement schemes (i.e. in-house or via an external provider), the additional GST costs would be passed on to investors. At a time when investors are facing extreme financial pressure due to the impact of the global COVID-19 pandemic and the effects it has had on all global markets and economies, an increase in the cost of savings as a result of GST will adversely affect retirement savings for New Zealand investors.

**For this reason, we submit that the inconsistent GST treatment of “management of a retirement scheme” be included in the issues being reviewed as part of the GST Issues Paper and, in line with the policy objectives of reducing GST bias and providing certainty of GST treatment, be addressed for all retirement savings industry participants.**

### **13. Way forward**

If you have any questions regarding this submission, please do not hesitate to contact us using the contact details provided above.

s 9(2)(a)



**Trustee Corporations Association of New Zealand Inc**

**22 May 2020**

## Milford Asset Management Limited

**Date** May 2020  
**Subject** GST policy issues - GST on manager and investment manager services  
**To** GST Policy ([policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz))

**Milford Asset Management Limited Submission:** GST policy issues paper, dated February 2020.

Milford is a NZ owned specialist investment firm which offers an extensive range of investment services and products, including KiwiSaver and other managed investment funds.

This submission relates specifically to 'Chapter 7 – Managed funds' on policy options for changing the GST treatment of manager and investment manager services supplied to managed funds.

### **A/ Our recommendation**

Chapter 7 of the GST policy paper sets out several options for how GST could apply to manager and investment manager services supplied to managed funds.

Inevitably, selecting the best option will require a trade-off between different policy objectives. As a general starting point, we recommend that Officials' base their decision on the following key principles.

#### ***Key Principles***

##### *1. Growing the long-term savings of New Zealanders*

Milford is a strong supporter and advocate for the continued promotion and growth of New Zealanders longer-term savings. This is a fundamental policy that needs continued support. Since its introduction, KiwiSaver has been hugely successful in fostering a savings culture and mindset for New Zealanders (a metaphorical shot in the arm), with c. \$60bn in savings (and almost 3 million investors), which will grow exponentially over the coming decades. For a variety of reasons, many New Zealanders also choose to save in non-retirement managed funds, for example, because they wish to access a product type which is not available within KiwiSaver or because they require more flexibility to draw on their savings.

We are concerned that any policy changes that have the effect of directly or indirectly increasing the cost to investors on their savings (whereby all or some of the additional GST impost is passed onto investors) will ultimately impact investor returns through higher fees and could therefore undo some of the progress made to date in promoting New Zealand's savings culture. In addition, it has the potential to lead to the unintended promotion of poor investor behaviour and outcomes.

We acknowledge that there is likely to be a trade-off between the policy objective of having a broad-based GST system with very few exemptions versus the objective of encouraging a savings and investment culture in New Zealand. For example, while making all investment management services fully taxable supplies (Option 1 in the Issues Paper) is consistent with a broad-based GST system, we believe this is the worst outcome for growing investment and savings in New Zealand. This could have the effect of distorting investment decisions where New Zealanders either choose not to save, or they choose to save through direct investment and forgo the benefits of investing collectively through a managed fund.

In contrast, it is typically tax incentives (not disincentives) that other jurisdictions across the globe have implemented to help further promote their superannuation and savings policy objectives.



Finally, it is important to consider fairness and “vertical equity” by ensuring any change does not impact lower income earners more severely. KiwiSaver has been a huge success in increasing the savings culture among New Zealanders in the lower- and middle-income brackets. Since GST is a regressive tax, any introduction of GST on services to retirement schemes would be particularly unwelcome.

### *2. Consistency of GST treatment among different providers, operating models and investment products*

The Issues Paper acknowledges the existing distortions between the GST treatment adopted by different investment managers depending on their product type, operating model or interpretation of the law.

Ideally, there should be consistency in the GST rules applicable to different providers of discretionary investment management services irrespective of:

- (a) Their product type (e.g., KiwiSaver funds, non-KiwiSaver unit trust funds or discretionary investment management services (DIMs)); or
- (b) Their operating model (i.e., whether they insource or outsource services).

The status quo where investment managers can effectively choose which GST rules to apply (provided they are consistent in their chosen method) creates inefficient and inequitable outcomes in our view.

### *3. Certainty and simplicity*

Certainty for the industry is key to enabling sustainable planning and more informed decision making. Milford would welcome a swift resolution to Government’s position in relation to the ongoing GST treatment of managed funds as this has been a long-standing industry issue.

The zero-rating option (Option 4 in the Issues Paper) is attractive to the industry on the basis that investment fund managers could recover a larger portion of GST on their outsourced costs without passing on GST to managed funds and their investors. However, we are very mindful of the fiscal cost of this option, particularly given the current environment and the scale of Government spending in relation to New Zealand’s response to Covid-19. We are also concerned that it may not be possible to legislate without a more comprehensive review of New Zealand’s GST treatment of all financial services.

Ideally, the chosen option would be simple and cost effective for the industry to apply and for investors to understand.

#### ***Recommendation: Treat all discretionary investment management services as GST exempt supplies***

Based on the first key principle above, our strong recommendation is that the Government should not make investment management services 100% taxable supplies.

Milford’s preference is one of the remaining options. On balance, we think treating all discretionary management services as GST exempt supplies is the best option, irrespective of whether those services are provided to a retirement fund, a non-retirement fund or directly to an investor via a DIMs mandate. This is on the basis that:

- Treating all discretionary investment management services as GST exempt is consistent with the promotion of a long-term savings culture in New Zealand.
- This option ensures consistency across different providers and products and therefore removes the risk of poor investor behaviour where investment decisions are based on taxation as opposed to suitability.
- This option is simple and cost effective. In particular, GST related administration time and costs should be reduced as investment managers will not be required to apportion their costs between taxable and exempt supplies, and some providers may be able to deregister for GST entirely.
- The fiscal cost for New Zealand should be lower than zero-rating or a reduced input credit approach and therefore we would expect this option could be legislated sooner, thereby removing the existing uncertainty within the industry.

It is worth noting the GST inconsistency for outsourced functions such as registry, unit pricing and fund administration and the potential bias towards “insourcing”. These functions are currently outsourced by

many providers and this is an operating model that is endorsed by the FMA. We would support any changes to investment manager services being consistently applied to these functions also.

### B/ Milford’s preferred options with pros and cons

In the table below, we have summarised Milford’s preferred options in descending order together with the pros and cons of each option.

Policy options	Pros	Cons
Exempt	<ul style="list-style-type: none"> <li>• Promotes NZ’s saving culture</li> <li>• Aligns non-retirement schemes and DIMs with retirement schemes</li> <li>• Removes bias and potential for poor customer outcomes</li> <li>• No additional cost for investors</li> <li>• Lower fiscal impact</li> <li>• Certainty</li> </ul>	<ul style="list-style-type: none"> <li>• Fund managers ability to claim GST on outsourced fund services</li> </ul>
Zero-rated / Reduced input credit	<ul style="list-style-type: none"> <li>• Promotes NZ’s saving culture</li> <li>• Fund managers can claim full or partial GST</li> <li>• No additional cost for investors</li> <li>• The potential for alignment across products</li> <li>• Certainty</li> </ul>	<ul style="list-style-type: none"> <li>• Fiscal cost</li> <li>• Inconsistency with other financial services provided to retail investors</li> <li>• Likelihood of prolonged consultation and ongoing uncertainty</li> </ul>
10% taxable supplies	<ul style="list-style-type: none"> <li>• Savings culture unlikely to be harmed</li> <li>• Less bias if retirement schemes remain exempt compared to 100% taxable supplies</li> <li>• No industry change for some providers already using this option</li> <li>• Would need to be legislated and better enforced to ensure consistency across different providers</li> <li>• Degree of certainty</li> <li>• Unlikely to be material cost to investors</li> </ul>	<ul style="list-style-type: none"> <li>• Less certainty than the options above</li> <li>• Inconsistent application of the rules by different providers</li> <li>• Small cost to investors if passed on</li> <li>• Potential misalignment with retirement schemes</li> </ul>
Taxable supplies	<ul style="list-style-type: none"> <li>• Fund managers can claim full GST on outsourced services</li> </ul>	<ul style="list-style-type: none"> <li>• Likely shift the tax/cost burden to investors via increased fees which does not align with the promotion of New Zealand’s savings culture.</li> <li>• Non-alignment between products if retirement schemes remain exempt</li> <li>• Potential to create bias in investment decisions leading to poor customer outcomes</li> <li>• Government taxing its own KiwiSaver contributions if fund manager services to retirement schemes are fully taxable</li> </ul>

### C/ Other questions for submitters

While we haven’t specifically addressed the second and third questions in the Issues paper, we would expect additional consultation on the definitions of key terms and an appropriate length of time for providers to work through transitional issues should any new laws be enacted.

# Financial Services Council.

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Friday 22 May 2020

GST Policy Issues

C/- Deputy Commissioner, Policy and Strategy

Inland Revenue

P O Box 2198

Wellington

New Zealand

By email: [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz)

## **Submission: GST Policy Issues**

This submission on the GST Policy Issues paper issued by Policy Officials of Inland Revenue (the Paper) is from the Financial Services Council of New Zealand Incorporated (FSC) and focuses on:

- Not in scope [REDACTED]
- [REDACTED]
- Chapter 7 – GST policy options for the GST treatment of manager and investment manager services supplied to managed funds
- Not in scope [REDACTED]

The FSC is a non-profit member organisation and the voice of the financial services sector in New Zealand. Our 64 members comprise 95% of the life insurance market in New Zealand and manage funds of more than \$89bn. Members include the major insurers in life, disability and income insurance, fund managers, KiwiSaver and workplace savings schemes (including restricted schemes), professional service providers, and technology providers to the financial services sector.

Our submission has been developed through consultation with FSC members and represents the views of our members. We acknowledge the time and input of our members in contributing to this submission.

The FSC's guiding vision is to be the voice of New Zealand's financial services industry and we strongly support initiatives that are designed to deliver:

- strong and sustainable customer outcomes
- sustainability of the financial services sector
- increasing professionalism and trust of the industry.

Over the past few years, the FSC has spent a considerable amount of time discussing and providing detailed submissions, including analysis to Inland Revenue personnel, on the application and outcomes under the current GST rules for Fund Managers, Funds and investors. We welcome the entire review of the GST policy relating to managed funds and the services provided as this is a complex area of GST.

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The FSC Taxation Advisory Group Committee met on 1 May 2018 with Inland Revenue personnel to discuss the GST policy options outlined in chapter 7 of the Paper including fees paid to unit trust managers and investment managers. We subsequently sent a letter of response to Policy Officials Chris Gillion and Gordon Witte on 23 May 2018 (refer Appendix 1 of this submission). This and earlier submissions form the background to this submission.

We welcome the opportunity to provide feedback on the Paper and any subsequent Bill drafted. In light of the Coronavirus disease 2019 (Covid-19) pandemic and the current and subsequent impact this will have on the New Zealand economy, to help guide us, FSC members will continue to follow the principles of the [FSC Code of Conduct](#) to ensure that consumers come first.

Our responses to the applicable consultation questions are attached.

I can be contacted on s 9(2)(a) to discuss any element of our submission.


Yours sincerely

s 9(2)(a)

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Not in scope



## Chapter 7 – Managed Funds

**What are the pros, cons or practical issues associated with each of the policy options? How well would they achieve the policy objectives?**

We consider the key items as follows:

- There should be a common GST position for all participants providing management and investment management services in the managed funds industry
- GST is a cost to the ultimate investors, for example KiwiSaver investors, as GST cannot be recovered by a managed fund
- GST incurred by a fund manager may, in whole or in part, be passed on through manager fees if the manager is unable to recover GST it pays. Ultimate investors will bear any GST cost passed on in this way as well as GST charged to the fund
- Regulations require a manager and a supervisor for each managed fund to ensure a separation of functions and duties to protect investor interests
- Managers can and do engage other suppliers to provide services for the funds they manage. These existing contractual relationships differ depending on the manager and the services which are contracted and will vary from manager to manager
- There is an inherent bias in the current New Zealand GST system to insourcing for financial services. However, managed funds do not typically have employees, it is the manager and others who have employees. This is for efficiency and regulatory reasons.

The key concerns with GST and managed funds are the ultimate cost to investors and how to best deal with the insource bias inherent in the New Zealand GST system for financial services. There needs to be a level playing field across the industry and a tax position taken should not drive different commercial outcomes.

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This submission supports the policy option of zero-rating however it also addresses some of the other options to give clarity on how they may achieve some of the policy objectives but are not preferred as they may also present problems. Zero-rating overcomes some of the issues that arise with the other proposed options, particularly in relation to apportionment.

Funds management, investment management and supervision services are financial services for funds which invest in securities. The core function of these services is to arrange the buying and selling of securities in respect of a managed fund's investments, namely an inherently GST exempt supply that could qualify for zero-rating for policy reasons.

### **Zero -rating**

The FSC submits that the most appropriate GST treatment of fund management and investment management services provided to managed funds is to zero-rate them so that investors do not bear an increased cost resulting from a change in GST treatment (and the current commercial arrangements that have been implemented in the context of the current GST position). An increased cost is almost certain to arise from a move to fully taxable treatment (or an increase from the agreed 10% taxable component) in the form of GST borne directly by funds. A move to exempt treatment would result in an increased cost to fund managers in the form of irrecoverable GST, which may be passed on to investors. This is clearly not a good outcome for investors, particularly at the current time when Covid-19 has both had materially adverse impacts on investors' savings and increased nervousness around the financial future for many.

Zero rating also allows for existing structures and arrangements to continue with minimal disruption and it is a position that the whole of the industry can support. We note that the Inland Revenue considered the option of zero-rating financial services generally in some detail in the early 2000s. It was accepted the work justified the anti-cascading rules in section 11A(1)(q) (effective 1 January 2005), enabling a business to elect supplies to a registered person making taxable supplies to be zero-rated, rather than be GST exempt.

Zero-rating also addresses the insource bias. This bias can normally be addressed by "in housing" services. However, it is not practical for managed funds to employ staff. Employees would need to have multiple employment contracts (one for each fund). Funds would need to be aggregated to be of a sufficient size to justify employing staff rather than an investment manager. However, this would remove the operational and economic benefits of the multiple funds (which the FSC anticipates could result in higher fees for investors). Further, some specialised skills and expertise are not available in New Zealand. Legislative alternatives to addressing the insource bias, for example a reduced input tax credit, have their own difficulties. Refer to our comment on reduced input tax credit mechanisms in this submission. Zero-rating would also align the position with investors carrying out these services themselves. A self-supply is not a supply and removing the GST on equivalent services deals with the self-supply bias.

In addition, zero-rating of fund management/investment management services would also remove the tension that currently exists relating to services provided by specialist New Zealand based

## Financial Services Council.

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investment managers regarding whether their investment services involve “arranging” of financial services in respect of investment portfolio’s or provision of “advice” and identifying the portion subject to GST.

There are fiscal implications from zero-rating, namely fund managers will be able to increase input GST. That should be offset in part by an increase in income tax paid by fund managers and the funds (whose GST cost will reduce) and any reduction in GST costs for fund managers will be factored into the future setting of manager fees and a reduction passed on where possible. While we have not quantified the impact, we expect that the total fiscal impact is not material, particularly in the context of support being provided currently to other industries in response to Covid-19. We submit that the benefits of zero-rating far outweighs the fiscal cost.

### **Exempt financial services**

Whilst zero-rating is the preferred option of our members, treating these services as exempt supplies is a possible workable solution. However, it should also be noted that a possible outcome of exempt treatment is an increase in fees charged to investors as fund managers seek to recover the additional GST cost. This is not a desirable outcome for investors.

### **Reduced input tax credit mechanism**

Fund managers will have their own insource problems and their ability to insource services will depend on their size. A reduced input tax credit (RITC) would go some ways to assist in addressing the insource bias and, if it applied for fund managers rather than the funds, reducing the compliance costs of a RITC. We note that in Australia, RITC requires the funds to register and claim the RITC. If the same was applied in New Zealand, a considerable amount of funds would need to register which is not a desired outcome for the industry nor the Inland Revenue. This compares to at least ten times less if licensed managers and financial service providers were required to register.

A RITC does have design questions, namely the difficulty in ascertaining what is the correct level of cascading input tax that should be allowed for particular services. Accordingly, a proxy would need to be agreed which would not be “correct”, but it is a compromise that would need to be accepted.

### **Deem a percentage to be exempt (and the remainder taxable)**

The FSC’s existing agreement with Inland Revenue treats part of the services as taxable. At the time of the agreement, fund managers were taking different positions and competing on the GST position. Inland Revenue was uncertain on the appropriate characterisation as the services include elements which might be considered taxable. The agreement was struck to reduce uncertainty and “GST competition”.

The difficulty with a partly exempt, partly taxable solution is determining the “correct” apportionment. A fund by fund apportionment, which would likely be retrospective, would be compliance costly and uncertain. An agreed apportionment would provide certainty but would operate as a “toll” for those where the rate struck was too high. To operate as a viable solution the taxable proportion should be low but this option remains problematic.

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## **Services should not be fully taxable**

Maintaining the customer as the primary consideration, services should not be a fully taxable supply as investors will ultimately bear an increased GST cost for financial services. Funds, and services to funds, may need to undergo restructuring. If direct management of investment portfolios in New Zealand was reduced and funds were forced to invest in foreign collective investment vehicles this would also negatively impact economic activity in New Zealand.

## **Defining the relevant management and investment management services**

The Paper proposes that the terms “manager”, “investment manager” and “managed investment scheme” could be defined by referencing the existing definitions of these terms in section 6(1) and section 9 of the Financial Markets Conduct Act 2013 (FMCA) and these definitions could be applied to confirm which services are subject to the future policy. Our members support linking definitions with the FMCA as this would enable definitions to be targeted to the types of taxpayers that Inland Revenue and industry intended to be captured by the proposal. Fund Managers will need to apply the definitions to the services that they and others provide to managed funds. They will need to determine which services are within the scope of the definition and which are not and which are provided to them and which to the fund (i.e. the manager pays for the service as agent for the fund). Depending on which model they apply, they may need to unbundle fees to ensure that only the manager and investment manager services are zero-rated. This is factored into our submission on the transition.

It is recommended that any changes apply from 1 April 2022, being the start of financial year for most retail managed fund products. This would also seek to minimise the impact of other regulatory reporting obligations such as fund updates, enabling all fund managers to adopt the same GST status on the same date subsequently aiding fund comparisons.

## **What types of manager and investment manager services should the proposed policy or law change apply to? What is the clearest way to define the relevant services?**

There are essentially two structures or models, the first being where the fund manager has a flat fee for all services and the other is where there is a management fee and direct charges are made to the fund. It would need to be made clear that zero-rating only applies to management fees and not bundled fees and the legislation would need to state precisely what is able to be zero rated. An apportionment methodology for bundled fees is required. That needs to be legislated so that there are clear rules.

## **If the law was changed, what transitional issues could arise and what measures could be implemented to enable a smooth transition to the new law?**

We recommend that a grandfathering provision be put in place to ensure a smooth transition from existing arrangements to zero-rating and to ensure consistency across fund managers over time. A phased approach over the next three years would also ensure that compliance costs are manageable when the industry is experiencing significant change and strain as a result of Covid-19.

Other than renegotiation of commercial contracts, the other transitional issue will be the updating of disclosure documents to clarify GST positions regarding fee and expense disclosures.



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### Appendix One: Content of letter to IR, 23 May 2018

The FSC supports either the 10% or exempt options as viable options. However, we consider that legislating the status quo of GST on 10% of unit trust manager's fees for management services to unit trusts and 10% of investment management fees for direct and indirect services provided by investment managers is likely to be the better option. This would have the least impact on the industry's current practices and the tax revenue (GST, income tax and employment-related taxes) collected by Inland Revenue. This should also apply to out of fund fees. Out of fund fees refer to the scenario where a fund invests into another wholesale fund that is managed by another manager, but the management fee of that other manager is invoiced directly to the manager of the fund (rather than charged to the wholesale fund). This occurs to ensure that there is no duplication of investment management fees. We consider that GST should not incentivise any change to this approach. We have accordingly, referred to the indirect provision of the services to cover this.

In considering a possible definition of investment management services to which the GST on 10% of investment management fees should apply, we looked at the legislative definition of services that would qualify for exemption could be based on the Financial Markets Conduct Act 2013 (FMCA) requirements and associated guidelines for licensing and regulation of outsourcing of investment management services by fund managers.

There is precedent for using the FMCA in the Goods and Services Act 1985 (GST Act), for example, "retirement scheme" in section 3 is defined by reference to section 6(1) of the FMCA. It should align the tax policy with regulatory treatment so that any use of the amendment is "controlled". In other words, if a taxpayer takes a position that the service is within the new definition, the service can be expected to be regulated either directly (as regulation applies to the provider) or indirectly (as regulation applies through the regulation of outsourcing by a regulated provider).

We note that some managers outsource certain services (excluding investment management services) on behalf of a fund. The GST is therefore incurred by the fund and not the manager. It is not intended that the proposed definitions would change that result. We appreciate that it is likely that this initial suggestion will need to be modified as the policy process develops.



25 May 2020

Deputy Commissioner  
Policy and Strategy  
Inland Revenue Department

FROM: s 9(2)(a)  
DIRECT:  
MOBILE:  
EMAIL:  
REF:

**by email**

**SUBMISSIONS ON GST POLICY ISSUES — AN OFFICIALS' ISSUES PAPER**

- 1 Thank you for the opportunity to provide submissions on the Inland Revenue (*IR*) Officials' Issues Paper on GST policy issues (the *Paper*). Our submissions on the issues and proposals described in the Paper are set out below.

Not in scope

Not in scope


**Managed Funds**

***Proposed changes to GST for manager and investment manager services supplied to managed funds***

- 15 We agree that the current position is complex and is applied in an inconsistent way across the industry. A change that simplifies the position and is able to be applied consistently would be welcome. We consider that the guiding principles when determining the preferred approach should be as follows:
  - a. To minimise adverse impact on investors that could arise from either an increase in GST directly borne by funds or an increase in management fees reflecting increased GST burden on fund managers. We see this as particularly important in the current environment with recent reduction in savings balances and increased uncertainty in respect of future economic conditions.
  - b. Provide a level playing field for fund managers, so that those more able to pass on increased costs (or better able to in-source) are not in a favoured commercial position as a result of a tax law change.
  
- 16 Having regard to the above principles, we consider the preferred option for addressing management services provided to managed funds should be to treat those services as zero-rated supplies.
  
- 17 At paragraph 7.46 officials note that compared to the other policy options either zero-rating or a reduced input tax credit would mean investment manager services would be substantially undertaxed. We question whether the level of “undertaxing” would in fact be material. In any event, in a time where many other industries are receiving material support from the Government, a strong case can be made that the benefits of zero-rating exceed the costs.

Not in scope


Not in scope




28 We would be happy for officials to contact us to discuss the points raised.

Yours faithfully

s 9(2)(a)



DIRECT: s 9(2)(a)  
EMAIL: 


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<sup>1</sup> We consider the changes proposed to the adjustment provisions would entitle John to an input tax credit equal to the tax fraction of the market value if he commenced a taxable activity in respect of the land, instead of selling the land to Jasmine for her to commence a taxable activity. It would be inconsistent to limit Jasmine's input tax credit to John's original cost, when John would not be limited in the same way if he decided to use the land for a taxable activity.

**GST policy issues – Deloitte submission**

Chapter/Issue	Deloitte comments
Not in scope	

Not in scope



**Chapter Seven:** Managed Funds


Deloitte acknowledges that the managed funds industry is a complex area and

Issue: The GST treatment of different types of management services supplied to managed funds is complex and applies inconsistently.

consider that great care must be taken if any changes are made to these rules.

Where changes are made to these rules consideration would need to be made to other similar activities such as superannuation.

Not in scope









POLICY AND REGULATORY STEWARDSHIP


**Tax policy report: GST treatment of services supplied to managed funds**

<b>Date:</b>	12 April 2022	<b>Priority:</b>	Medium
<b>Security level:</b>	In Confidence	<b>Report number:</b>	IR2022/152 T2022/848

**Action sought**

	<b>Action sought</b>	<b>Deadline</b>
Minister of Finance	<b>Agree</b> to recommendations	4 May 2022
Minister of Revenue	<b>Agree</b> to recommendations <b>Refer</b> a copy of this report to the Minister of Commerce and Consumer Affairs	4 May 2022

**Contact for telephone discussion (if required)**

<b>Name</b>	<b>Position</b>	<b>Telephone</b>
Stephen Bond	Manager, Tax Strategy, The Treasury	s 9(2)(a)
Gordon Witte	Principal Policy Advisor, Inland Revenue	s 9(2)(a)

12 April 2022

Minister of Finance  
Minister of Revenue

## **GST treatment of services supplied to managed funds**

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### **Executive summary**

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#### **Purpose**

1. This report seeks your decision on how GST should apply to services that fund managers and investment managers provide to KiwiSaver and other managed funds.

#### **Context and background**

2. The current GST treatment of management services supplied to managed funds is complex and inconsistent. It can differ depending on the type of manager which is supplying the service (a manager or an investment manager) or the type of fund (a retirement scheme, or other type of fund) which is receiving the service.
3. There are three different industry practices ranging from:
  - A full GST exemption (no GST charged) when the relevant services qualify for the GST exemption for management of a retirement scheme;
  - Treating 90% of their services as exempt, and effectively charging 1.5% GST on their fees (15% GST on 10% of their fees); and
  - Charging 15% GST on all their services.
4. The inconsistent GST practices mean there is an uneven playing field for pricing these services which may distort competition. It also leads to higher compliance costs, and less revenue.
5. Many of the current practices are not consistent with current GST laws, so a law change is necessary to either allow the current inconsistent practices to continue, or to set a certain and consistent GST treatment.

#### ***Legislative change is required but the affected parties disagree on the preferred policy option***

6. The managed funds industry agrees that a legislative change should be introduced to provide certainty and reduce compliance costs.
7. However, there are two different stakeholder views as to what the GST treatment should be:
  - **Option 1. Retain status quo.** This would legislate to allow current practices to continue. The Financial Services Council (who represent large, mature funds) prefers this option.
  - **Option 2. Making services supplied by fund managers and investment managers subject to 15% GST.** This would legislate to require GST to be charged

on all services supplied to managed funds. This option is preferred by a group of boutique fund managers and is consistent with their current practice.

8. The main trade-off between the two options is that applying more GST to managed funds will ensure consistency across the industry, will raise revenue, and is less likely to create pressure for further exemptions. However, this will increase costs for managed funds, which is likely to increase fees and reduce returns from savings, and consequently reduce future balances in KiwiSaver and other managed funds.

### **Recommended policy option**

9. Inland Revenue and Treasury recommend Option 2: Making services supplied by fund managers and investment managers subject to 15% GST. We consider that this will lead to a more consistent treatment and therefore an even playing field across the industry. It will also reduce compliance costs, improve integrity and be more sustainable. This option would raise revenue in a manner consistent with our GST frameworks.
10. We acknowledge that this would lead to higher fees for savers and transitional costs for the industry. However, we consider these costs can be mitigated by options considered further below and that the benefits of this option will outweigh these costs.

### **Additional GST revenue**

11. Inland Revenue estimates that applying GST to the manager and investment manager fees would raise approximately \$250 million to \$300 million per annum of additional GST revenue.

### **Impact on fees charged to retail investors**

12. We expect that applying more GST to managed funds would increase the fees charged to retail investors (such as KiwiSaver members). To the extent that fees increase, this will reduce after-fee returns and therefore the total amounts that are reinvested and, ultimately, future retirement balances.
13. If Ministers are concerned about the managed funds fees increasing because of applying GST, then we recommend considering non-GST options for supporting savers. This could include, for example, options such as an explicit fee subsidy or increasing the Government contribution. Such options could also be better targeted to benefit savers with smaller balances (as opposed to GST concessions, which would produce the most benefit for savers with large balances).
14. We consider that these non-GST options are preferable and are likely to be more direct and effective options than a GST concession. New Zealand's GST system has not been previously used to reduce the price of specific goods or services (unlike other countries, which have concessions, for example, on food and education), so it would be an adverse precedent to provide GST concessions to reduce the price of managed fund fees.
15. The Treasury recommends that you consider these options alongside your wider fiscal and other objectives. The revenue from our preferred policy option (to make services supplied by fund managers and investment managers subject to 15% GST) could, for instance, be used to increase spending or reduce taxes in other areas and this should be compared alongside options to support savers.

### **Application date**

16. To mitigate the transitional costs, we recommend providing an adequate transitional period between enactment and when the new rules would apply. For example, 24-36 months could provide time for the hundreds of affected taxpayers to amend their IT systems, adjust their business practices and replace or renegotiate commercial

contracts, to align with the new rules. A shorter transitional period, such as 12 months, would have a fiscal benefit of collecting GST revenue sooner, but we would recommend against this as it could impose much more disruption to the managed funds industry and associated implementation challenges and transitional costs.

17. We will provide updated advice on the application date and estimated fiscal implications when we report back in May 2022 with a draft Cabinet paper. We are currently seeking further information on transitional costs and more recent managed funds data is expected to be published soon.

### Next steps

18. Officials are available to meet you, at your earliest convenience, to discuss this report.
19. Following your decision, officials will report back with a draft Cabinet paper and Regulatory Impact Statement seeking Cabinet approval of your decision. An indicative timeframe for this Cabinet paper would be:
- |         |   |
|---------|---|
| 9 May   | Report back to the Minister of Revenue with a draft Cabinet paper and Regulatory Impact Statement |
| 16 June | Lodgement of Cabinet paper for DEV (10am 16 June)   |
| 22 June | DEV consideration of Cabinet paper  |
| 27 June | Cabinet approval  |
20. This timeframe would allow the proposed legislative change to be included in the omnibus Taxation Bill which is scheduled for introduction in August 2022 and enactment in late March 2023. s 9(2)(f)(iv)

### Recommended action

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21. We recommend that you:
22. **agree** to one of these two options:
- 22.1 Option 1 –Legislating to allow the current inconsistent GST practices to continue); OR
- |                   |                   |
|-------------------|-------------------|
| Agreed/Not agreed | Agreed/Not agreed |
|-------------------|-------------------|
- 22.2 Option 2 – Making services supplied by fund managers and investment managers subject to 15% GST (Inland Revenue and the Treasury’s preferred option);
- |                   |                   |
|-------------------|-------------------|
| Agreed/Not agreed | Agreed/Not agreed |
|-------------------|-------------------|
23. **note** we expect that option 2 would increase fees for retail investors, such as KiwiSaver members. To the extent that fees increase, this would reduce after-fee returns and therefore the total amounts that are reinvested and, ultimately, future retirement balances;
- |       |       |
|-------|-------|
| Noted | Noted |
|-------|-------|

24. **agree** that if option 2 proceeds, an adequate transitional period, such as 24-36 months after enactment, be provided to ensure it is viable for funds and service providers to implement the new rules and to mitigate the transitional costs.

Agreed/Not agreed

Agreed/Not agreed

25. **note** with a 1 April 2025 start date (24 months after enactment), the estimated fiscal impact of option 2 is the revenue gains shown in the following table;

	\$m – increase/(decrease)				
<b>Vote Revenue</b>	<b>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>
Crown Revenue and Receipts:					
Tax Revenue	\$0	\$0	\$0	\$42.0	\$275.0
<b>Total change in Revenue</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$42.0</b>	<b>\$275.0</b>

Noted

Noted

26. **note** we will provide updated advice on the application date and estimated fiscal implications when we report back in May 2022 with a draft Cabinet paper;

Noted

Noted

27. **refer** a copy of this report to the Minister of Commerce and Consumer Affairs for their information.

Referred/Not referred

s 9(2)(a)

**Stephen Bond**  
 Manager, Tax Strategy  
 The Treasury

**Graeme Morrison**  
 Policy Lead  
 Inland Revenue

**Hon Grant Robertson**  
 Minister of Finance  
 / /2022

**Hon David Parker**  
 Minister of Revenue  
 / /2022

## Background

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28. The current GST treatment of different types of management services supplied to managed funds is complex and inconsistent.
29. KiwiSaver funds and other types of managed funds purchase three main types of services from third parties:
  - **Manager services.** A fund manager has overall responsibility for managing the fund. This includes offering and issuing units in the fund to investors, managing the fund's investments, reporting to investors, and procuring services from an investment manager and various administration service providers.
  - **Investment manager services.** These involve an investment manager managing which assets (shares, bonds, cash) or other funds the fund invests into. When reporting to investors, manager services and investment manager services are both reported as "management fees" which are set as a very small percentage (typically between 0.2% and 2%) of the funds under management.
  - **Various administrative services** such as legal, accounting, ICT (information and communications technology) or reporting services.
30. The providers of these services apply GST inconsistently and this results in an uneven playing field across the industry.<sup>1</sup>

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<sup>1</sup> Unlike many other industries, any GST applied to these services represent a real cost for managed funds. This is because under New Zealand's GST rules managed funds are 'exempt' from GST. This means they cannot claim back GST charged to them, but at the same time do not need to apply GST to the fees they apply to consumers.

### **How the industry is applying GST to fees**

The industry applies three main GST practices:

- **GST exempt.** There is a GST exemption which applies when management services are provided directly to a retirement scheme (such as a manager providing services directly to a KiwiSaver scheme). However, this exemption does not apply to most structures where a retirement scheme invests into a variety of underlying wholesale funds (NZ fixed interest, international shares etc.), as the managers and investment managers will be providing their services to the wholesale fund rather than to the retirement scheme.

For manager and investment manager services provided to other types of managed fund (including wholesale funds which other funds invest into), there are two different GST practices:

- **90% exempt.** The largest fund managers and investment managers typically treat ten percent of their services as being subject to 15% GST and the remaining ninety percent as exempt from GST (because they consider their services are mostly "arranging" the buying and selling of investment products and so should qualify for the GST exemption for financial services). This may allow them to charge lower fees to the wholesale funds (as they effectively only charge 1.5% GST on their management fees). This ratio was historically accepted by Inland Revenue since 2001, until a new draft interpretation was developed in 2017.
- **GST on all fees.** A group of boutique managers and investment managers apply 15% GST to all of their services (as in their view their services are providing investment "advice" or other types of services that are subject to 15% GST). This simplifies GST compliance and allows the fund manager or investment manager to claim GST deductions (refunds) on their purchases, such as commercial rent, research, software, ICT and administrative services etc.

Most non-management services supplied to managed funds, such as administrative services, are subject to GST.

31. Many of the current GST practices employed by the industry, such as the 90% exempt treatment, are not consistent with existing GST laws. This means that retaining the status quo would require a law change.

### **Problems with current GST practices**

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32. There are three main problems with current GST practices.

#### ***Competitive advantage***

33. The current GST rules distort competition by favouring certain types of managed funds. The inconsistent GST practices have allowed some fund managers to structure themselves to develop a competitive advantage over others, though there is limited evidence of these impacts.
34. Some stakeholders have experienced the issue of funds 'shopping around' potential fund managers and enquiring about the GST treatment they would be subject to. If the fund manager cannot provide the GST treatment desired, this may result in them being unfavourably considered for supplying the service.
35. More generally, the current GST exemption for management services provided to retirement schemes may favour certain funds and business structures over others.

The distinction between retirement schemes and other funds does not reflect the fact that most retirement schemes invest into wholesale funds. Both types of funds can be used for long-term savings and apply the same income tax rules.

### **Compliance costs**

36. The current GST rules also impose compliance costs of correctly identifying and applying different GST treatments depending on the type of service being provided. The compliance costs may include seeking specialist tax advice and the risks of errors or disputes.

### **In-source bias**

37. The current GST rules may create a bias for performing certain services in-house where possible rather than outsourcing. This is because if a manager or investment manager's service is regarded to be GST exempt, they will be unable to recover GST on any inputs they purchase from outside their organisation (such as commercial rent, accounting, and ICT services) to deliver their own service. These GST costs would not arise if they provided the services within their own organisation (in-house).

### **Differing stakeholder views**

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38. Inland Revenue has been consulting with managed funds about the GST treatment of manager and investment manager fees. The issue and a range of policy options were publicly consulted on in a GST policy issues paper in 2020.
39. Inland Revenue had a further round of targeted consultation meetings with the Financial Services Council (which represents most of the large managed funds) and a group of boutique managed fund providers in November and December 2021.
40. There are two different stakeholder views on how the law should be changed:
- **Option 1: Retain status quo.** The Financial Services Council has expressed a preference on behalf of the large, mature funds it represents for legislating to allow the current, inconsistent GST practices to be able to continue.
  - **Option 2: Making services supplied by fund managers and investment managers subject to 15% GST.** In contrast, the boutique fund managers consider that GST should apply to all manager fees. This would be consistent with these boutique fund managers applying GST to their fees currently. This allows these fund managers to claim GST refunds for GST charged on inputs, such as rent or administrative services, that they buy from external providers.
41. The advantages, disadvantages, and impacts of these two policy options are discussed below.
42. Some additional policy reform options and their impacts are also analysed in the attached draft Regulatory Impact Statement.



## Options analysis

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### Option 1: Legislating to allow the current inconsistent GST practices to continue

43. Under this option, managed funds will be able to choose between one of three GST treatments. These three treatments are the range of current practices undertaken by the industry:
- **Fully exempt.** This option includes retaining a GST exemption for when management services are directly provided to a retirement scheme (such as a manager providing services directly to a KiwiSaver scheme).
  - **90% exempt.** Treating 90% of their services as exempt and effectively charging 1.5% GST on their fees (15% GST on 10% of their fees). This practice is applied by most retail managed funds and by wholesale funds that other funds, such as retirement schemes, invest into.
  - **Full GST.** Charging 15% GST on all their services. This practice is applied by a small number of boutique funds.
44. One of the main stakeholders, the Financial Services Council, which represents large and mature managed funds, has expressed a preference for legislating that the current GST practices be able to continue.
45. Legislation is required if you prefer this option. This is because many of the current industry practices, such as the 90% exempt treatment, are not consistent with existing GST laws.

#### Advantages of option 1

##### ***No impact on savers***

46. This option does not increase costs for managed funds. As a result, it will not lead to increased fees for savers and will avoid reductions in future balances (including retirement balances) that an increase in GST costs would cause.

##### ***No change costs***

47. Another advantage of this option is that unlike the other policy options, it does not impose change costs on the managed funds industry. These change costs would include scheduling, building, and testing IT systems changes, updating reporting, communications and training staff for customer contacts relating to fee increases. MBIE and the Financial Markets Authority have noted that any GST change costs would occur at a time when the industry is implementing a lot of other regulatory changes, such as climate reporting disclosures and proposed changes to anti-money laundering rules.
48. This option is also likely to be supported by most of the affected funds and service providers as it does not require them to change their longstanding practices and allows each of them to continue with their preferred GST treatment.

#### Disadvantages

##### ***Complexity and inconsistency***

49. The main disadvantage of this option is that it entrenches the complexity and inconsistency of the current practices and the associated impacts on competition, compliance costs and risks of errors (these impacts were further explained in paragraphs 33-37 above).
50. This option would also involve two different exemption rules – a full exemption for management of retirement schemes (such as KiwiSaver) and an optional 90%

exemption for managers and investment managers which provide services to other types of funds (including the wholesale funds that most retirement schemes invest into). These differing exemptions could be complex to apply which increases the risks of inconsistency, errors, and disputes.

### ***Integrity***

51. This option would introduce new integrity risks. This includes the risk of managers “cherry picking”, which is where they may choose a taxable GST treatment to maximise GST deductions when they are starting up and later switch to an exempt treatment to minimise the GST they charge once they have a large amount of fee revenue.<sup>2</sup>

### ***Precedent effects and boundary issues***

52. More generally, tax exemptions tend to widen over time and become more complex and costly (both fiscally and for taxpayer compliance costs). This makes them difficult to maintain and administer.
53. An exemption creates boundary issues in determining whether a service is a management service or another type of service. For example, there could be incentives to bundle or reclassify some other types of services as being management services to further reduce GST costs for managed funds. This has been the experience in European Union countries where case law has found that the “management” of an investment fund has a broad meaning for European Union VAT/GST purposes and can include administrative services and advice. In contrast, administrative services and advice are subject to GST in New Zealand.<sup>3</sup>

### ***Revenue impact***

54. Because option 1 aligns with the current GST positions in the revenue baselines, it would be fiscally neutral.

## **Option 2: Making services supplied by fund managers and investment managers subject to 15% GST**

55. Under option 2, all manager and investment fees will be subject to GST.
56. The other main stakeholder, the boutique funds, prefer this option. This is because it provides a level playing field with other funds and reduces some compliance costs (as all fees have the same GST treatment and it allows them to claim GST refunds for all their purchases).

### **Advantages of option 2**

#### ***Competitive neutrality***

57. This option would mean all providers of these services compete on a level playing field. All their relevant fees would become subject to 15% GST rather than some being treated as exempt or 90% exempt (effectively 1.5% GST). General managed funds and retirement schemes that invest into underlying wholesale funds would no longer be disadvantaged when compared to retirement schemes that procure management services directly.

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<sup>2</sup> One option to prevent this risk would be to require an irrevocable election for the GST treatment, but imposing such a rule could be a barrier to funds acquiring other funds to achieve efficiency benefits, such as economies of scale

<sup>3</sup> General accounting and record package services are excluded from the definition of exempt financial services, and advice is excluded from the exemption for arranging the supply of a financial service.

### ***Simplicity and compliance costs***

58. Applying GST to all services provided by fund managers and investment managers would simplify GST compliance as they would be able to claim GST deductions for all the GST charged on their external costs.

### ***Integrity and precedent effect***

59. We consider this option is more sustainable in the long term. It is less likely to lead to calls for further exceptions or put additional pressure on the boundary of the rules over time. Management services provided to funds would have the same GST treatment as administrative services and advice. This consistency removes pressure to define, bundle or reclassify these services and the associated risks of errors or disputes.

### ***Revenue***

60. Inland Revenue estimates that this option could raise approximately \$250 million to \$300 million per annum of additional GST revenue. The estimated revenue depends on the proposed application date and estimated values of the affected managed fund assets and fees at that time.

### ***Disadvantages***

#### ***Impact on retail fees charged to investors***

61. We expect that the additional GST collected under this option will lead to higher fees for retail investors, such as KiwiSaver members. To the extent that fees increase, this will reduce after-fee returns and therefore the total amounts that are reinvested and the available balances at future dates (e.g., KiwiSaver members would have less available when they withdraw funds to purchase a first home, or at their retirement).
62. The extent to which GST will lead to higher fees for retail investors is uncertain. The economic literature for other types of GST increases and decreases has found they are more likely to affect the prices paid by consumers (in this case, retail investors) in more competitive markets<sup>4</sup> or if the GST reform is broader.
63. New Zealand's managed fund fees are regarded as being less competitive (higher fees) than other countries.<sup>5</sup> This could suggest that some funds may be able to offset or absorb some of the additional GST cost pressures by changing their commercial practices<sup>6</sup> or reducing their profit margins, rather than raising their fees by the full amount of added GST cost.
64. Feedback from submitters was mixed regarding how much they expected fees would increase. The boutique funds submitted that the additional GST costs may have little impact on fees charged to retail investors due to increasing pressures to compete on fees<sup>7</sup> and the proposed transitional period which would allow time to adjust. In contrast, other submitters, such as the Financial Services Council,

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<sup>4</sup> In more competitive markets, businesses have lower profit margins so are less able to absorb cost increases as an alternative to increasing their retail prices.

<sup>5</sup> Morningstar analysis recently reported that "in a global environment of shrinking fees, the [NZ] industry risks falling behind global peers, given the improvements in fees and expenses that other markets are making." <https://www.interest.co.nz/investing/115144/new-zealands-rating-drops-morningstar-analysis-fees-and-expenses-managed-funds>

<sup>6</sup> For example, by reallocating assets into lower cost wholesale funds or appointing new service providers

<sup>7</sup> For example, in 2021, some large KiwiSaver funds announced fee reductions.

considered the full impact of the GST cost would be passed through to retail investors.

65. Because management fees are set as a percent of the member's total balance, retail investors (such as KiwiSaver members) with higher balances and those that invest into higher fee funds could face larger dollar increases in fees and reductions in future balances. This is illustrated by the following examples.

**Illustrative examples of potential upper-limit impacts on fees and future balances**

Assume the fund is purchasing management services which are currently treated as being 90% exempt, 10% subject to GST (GST is effectively 1.5% on management services) and that management fees comprise 90% of the fund's total fees (the other 10% are administration fees).

Also assume the retail investor's balance grows by 10% each year (before fees) as they continue to regularly contribute funds and reinvest returns.

***Investor with \$37,500 in a fund with a 0.8% annual fee***

A retail investor with \$37,500 invested in a fund that charged a 0.8% fee under the status quo (option 1) would currently pay a \$300 annual fee. Under the proposed reform (option 2), and assuming the GST costs were fully passed through to the retail investor, their fee could increase by up to \$36, to become \$336 for the first year after the reform.

After 25 years of regular contributions and reinvesting, the investor would have had a \$310,009 balance under the status quo and a \$302,115 balance under the proposed reform, a reduction of \$7,894.

***Investor with \$100,000 in a fund with a 1% annual fee***

A retail investor with \$100,000 invested in a fund that charges a 1% fee would pay a \$1,000 annual fee under the status quo. Under the proposed reform, their annual fee could increase by up to \$120, to become \$1,120 for the first year after the reform.

After 25 years of regular contributions and reinvesting, the investor would have had a \$791,108 balance under the status quo and a \$765,323 balance under the proposed reform, a reduction of \$25,785.

66. Fees can have a large impact on the financial wellbeing of investors as they directly contribute to the level of accumulated savings, including retirement savings for retirement schemes such as KiwiSaver. Generally, fees should decrease over time as the economies of scale benefits from a growing 'funds under management' sector are available to be passed onto consumers. For this reason, the Government (through the KiwiSaver default provider appointment process) and the Financial Markets Authority have focussed in recent years on ensuring KiwiSaver members receive value for money.

### ***Transitional costs***

67. This option would impose significant transitional costs for most managers and investment managers that are not already applying 15% GST. Making the services subject to GST is the least preferred policy option of the mature funds represented by the Financial Services Council. This is because it would require them to shift from a fully exempt or 90% exempt treatment to GST applying to all the relevant fees.
68. The type of transitional costs involved and how they can be mitigated by providing a transitional period are further discussed in paragraphs 75-79 below.

### ***Recommended option***

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69. Inland Revenue and Treasury recommend Option 2: making services supplied by fund managers and investment managers subject to 15% GST. We consider that this would lead to a more consistent treatment and therefore an even playing field across the industry. It would also reduce compliance costs, improve integrity and be more sustainable. Option 2 would raise revenue in a manner consistent with our GST frameworks.
70. We acknowledge that this would lead to fees increasing and transitional costs for the industry. However, we consider these costs can be mitigated by options considered further below and that the benefits of this option will outweigh these costs.

### ***There are other policy options to reduce managed fund fees***

71. We note that recent measures, such as appointing new default KiwiSaver providers and improving fee transparency and comparison tools, are helping to place competitive pressure on fees. This highlights that there are a range of non-tax policy options to reduce fees.
72. If Ministers are concerned about the managed funds fees increasing because of applying GST, then we recommend considering non-GST options for supporting savers. This could include, for example, options such as an explicit fee subsidy or increasing Government contributions. Such options could also be better targeted to benefit savers with smaller balances (as opposed to GST concessions, which would produce the most benefit for savers with large balances).
73. We consider that these non-GST options are preferable and are likely to be more direct and effective than a GST concession. New Zealand's GST system has not been previously used to reduce the price of specific goods or services (unlike other countries, which have concessions, for example, on food and education), so it would be an adverse precedent to provide GST concessions to reduce the price of managed fund fees.
74. The Treasury recommends that you consider these options alongside your wider fiscal and other objectives. The revenue from our preferred policy option (to make services supplied by fund managers and investment managers subject to 15% GST) could, for instance, be used to increase spending or reduce taxes in other areas and this should be compared alongside options to support savers.

### ***Application date***

75. We are currently seeking further information from the Financial Services Council and other stakeholders about their expected transitional costs and will report back with further advice on the application date in May 2022 when we provide a draft Cabinet paper.
76. Many managed funds and service providers would face significant transitional costs in implementing the proposed change. There are currently 319 different KiwiSaver

funds (operated by 39 KiwiSaver schemes) and 727 non-KiwiSaver managed funds offered to retail investors. Nearly all of these funds will need to amend their IT systems, appoint new service providers, or renegotiate commercial contracts, update investor disclosure statements, and prepare communications and staff training to deal with increased contacts from customers.

77. Of the changes required, the changes to IT systems are likely to require the most time to prepare and implement. Many of the affected funds, such as those owned by banks, will have to plan, build, and test the IT changes around other significant IT projects. They will also be required to simultaneously implement a lot of other regulatory changes, such as climate reporting disclosures and proposed changes to anti-money laundering rules.
78. To ensure it is viable for funds and service providers to implement the proposed new rules and to mitigate the transitional costs, we recommend providing an adequate transitional period between enactment of the law change and when the new rules would apply. Our current best judgement, based on earlier submissions and discussions with stakeholders, is that 24 months should be sufficient. A shorter transition period, such as 12 months, would have a fiscal benefit of collecting GST revenue sooner, but we would recommend against this as it could impose much more disruption to the managed funds industry and associated implementation challenges and transitional costs.
79. The Financial Services Council have previously submitted that they require a 3 to 5-year transitional period and so we are seeking more information from them to help inform your decision.

### Financial implications

80. Subject to Ministers deciding to apply GST to the fees (option 2), and assuming a 1 April 2025 start date (24 months after enactment), our current best estimates of the fiscal impact of the changes are the revenue gains shown in the following table.

Vote Revenue	\$m – increase/(decrease)				
	2021/22	2022/23	2023/24	2024/25	2025/26
Crown Revenue and Receipts:					
Tax Revenue	\$0	\$0	\$0	\$42.0	\$275.0
<b>Total change in Revenue</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$42.0</b>	<b>\$275.0</b>

81. These estimates depend on the proposed application date. They are based on 30 September 2021 managed funds data and are sensitive to assumptions about future growth in management fees.<sup>8</sup>
82. We will provide updated advice on the application date and estimated fiscal implications when we report back in May 2022 with a draft Cabinet paper. We are

<sup>8</sup> The estimates assume a 10% per annum increase in the dollar value of management fees. This assumption is based on the dollar value of basic manager's fees on KiwiSaver and Non-KiwiSaver managed funds growing by an annualised average of 14% for the 3 years between 30 Sept 2018 and 30 Sept 2021. A more conservative 10% assumption is used as:

- the last 3 years have had historically high investment returns;
- the Sep 2021 data we use does not reflect recent reductions in fees from new lower fee default KiwiSaver providers being appointed and having assets transferred to them on 1 December 2021; and
- net contributions to KiwiSaver and other retirement schemes may reduce in future years as more of the population of investors reaches retirement age.

currently seeking further information on transitional costs which will inform the recommended application date and more recent data (for 31 December 2021) may have been published by then.

83. In May 2022, we will also seek your decision on how any additional revenue should be managed. In a recent instance, the fiscal impact of a tax change that was too large to be managed through the Tax Policy Scorecard was charged as a positive pre-commitment against Budget allowances. In other instances, the revenue impacts of large tax changes have been allowed to 'flow through' (i.e., to be reflected in forecasts but not allowances). Our initial view is that any additional revenue from this change should 'flow-through' to forecasts, but Ministers should take this into account when setting allowances at HYEPU later this year.

## Consultation

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84. The Ministry of Business Innovation and Employment (MBIE) and the Financial Markets Authority were consulted on this report.
85. MBIE supports the aim of having a consistent GST system and the benefits this may have for competitive neutrality and lower compliance costs. However, increased fees and lower net returns for retail investors as a result of additional GST will lead to decreased retirement savings being available to savers in the future, including KiwiSaver members. This outcome risks undermining the positive impacts of recent Government efforts to ensure value for money with KiwiSaver and that the benefits of economies of scale in the funds management sector are being passed to consumers in the form of lower fees.

## Next steps

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86. We recommend that you refer a copy of this report to the Minister of Commerce and Consumer Affairs.
87. Officials are available to meet you, at your earliest convenience, to discuss this report.
88. Following your decision, officials will report back with a draft Cabinet paper and Regulatory Impact Statement seeking Cabinet approval of your decision. An indicative timeframe for this Cabinet paper would be:
- |         |  |
|---------|--|
| 9 May   | Report back to the Minister of Revenue with a draft Cabinet paper and Regulatory Impact Statement. |
| 16 June | Lodgement of Cabinet paper for DEV (10am 16 June)  |
| 22 June | DEV consideration of Cabinet paper   |
| 27 June | Cabinet approval   |
89. This timeframe would allow the proposed legislative change to be included in the omnibus Taxation Bill which is scheduled for introduction in August 2022 and enactment in late March 2023. s 9(2)(f)(iv)







POLICY AND REGULATORY STEWARDSHIP


**Tax policy report: Cabinet paper – GST on fees charged to managed funds**

<b>Date:</b>	26 May 2022	<b>Priority:</b>	Medium
<b>Security level:</b>	In Confidence	<b>Report number:</b>	IR2022/240 T2022/1190

**Action sought**

	<b>Action sought</b>	<b>Deadline</b>
Minister of Finance	<b>Agree</b> to recommendations	1 June 2022
Minister of Revenue	<b>Agree</b> to recommendations <b>Authorise</b> the lodgement of the attached Cabinet paper	1 June 2022 By 10:00 a.m., Thursday 16 June 2022

**Contact for telephone discussion (if required)**

<b>Name</b>	<b>Position</b>	<b>Telephone</b>
Stephen Bond	Manager, Tax Strategy, The Treasury	s 9(2)(a)
Kelvin Stewart	Senior Policy Advisor, Inland Revenue	s 9(2)(a)

26 May 2022

Minister of Finance  
Minister of Revenue

## **Cabinet paper – GST on fees charged to managed funds**

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### **Executive summary**

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1. This report seeks final policy decisions on a suitable transition period before the agreed policy changes to the GST treatment of manager fees charged to managed funds (including KiwiSaver schemes) takes effect. Attached to this report is a draft Cabinet paper and Regulatory Impact Statement for the policy changes.
2. This report follows on from your decision in April to impose GST on fund manager and investment manager fees charged to managed funds (IR 2022/152, T2022/848 refers). The policy changes will apply a consistent GST treatment of 15% GST on fund manager and investment manager fees charged to managed funds.
3. The key outstanding decision is regarding when the policy changes should take effect (the application date). This report provides advice on either a 1 April 2025 (24-month) or 1 April 2026 (36-month) application date after enactment, likely to be before 1 April 2023.
4. As noted in the earlier report, for many fund managers and investment managers, adopting the new rules will impose significant transition costs on them, at a time where they are already facing transition costs for other high priority regulatory changes.
5. The fiscal impacts of the decision on application date depends on the chosen transitional period. Assuming a two-year transition period, the likely increase in revenue from this change would be approximately \$34 million in 2024/25 and \$225 million in 2025/26, with the revenue impact growing by approximately 10% per annum going forward. With a three-year implementation period, the revenue impact has a similar size and profile, but is delayed by a year. Rather than immediately recognising the impact on Budget allowances, we recommend providing further advice on this as part of the development of the Budget Policy Statement later this year.
6. If you agree with the recommended option of 1 April 2026 following enactment, we recommend you approve the attached Cabinet paper and lodge it with the Cabinet Office by 10am Thursday 16 June 2022 for consideration at the Cabinet Economic Development Committee (DEV Committee) meeting on Wednesday 22 June 2022. If you agree to an application date of 1 April 2025, we will provide your office with a revised draft Cabinet paper as soon as possible.
7. Once Cabinet approval has been obtained, the legislative amendments would be included in the next available omnibus taxation bill currently scheduled for introduction in August 2022.

### **Background**

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8. On 12 April 2022, we reported to you on the issue of how GST should apply to fund manager and investment manager services provided to KiwiSaver schemes and other managed funds (IR2022/152, T2022/848 refers).

9. The report outlined the problem that the current GST treatment of these manager services can vary, with some being inconsistent with current GST laws and potentially distorting market competition.
10. The report provided advice on two different policy options:
  - 10.1 **Retain the status quo** and legislate to allow for the current practices to continue (100% exempt, 90% exempt/10% taxable, or 100% taxable treatment). The Financial Services Council (who represents large fund managers) preferred this option.
  - 10.2 **Making these services subject to 15% GST.** A group of boutique fund managers preferred this option.
11. We recommended the option to subject the fees to 15% GST, as it would reduce compliance costs, improve integrity, and ensure consistency across the industry. However, the option would lead to higher fees for savers, such as KiwiSaver members, and would impose significant transitional costs.
12. You agreed to subject these fees to 15% GST and agreed in principle to an adequate transitional period (such as 24-36 months after enactment) to mitigate the transitional costs.

### **Key concerns raised by stakeholders**

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13. As explained in the earlier report, the decision to impose 15% GST on fund manager and investment manager fees charged to managed funds will have several adverse impacts.
14. We expect that charging more GST to managed funds will increase the fees charged to retail investors, including KiwiSaver members. To the extent the fees increase, this will reduce after-fee returns and therefore the total amounts that are reinvested and, ultimately, future retirement balances<sup>1</sup>.
15. Alongside this, stakeholders have recently suggested the proposed changes may encourage an unintended behavioural change in some managed funds, in that they may relocate their funds offshore to avoid incurring GST on the manager fees charged to the fund. This is because GST is not collected on services supplied to offshore domiciled funds, which a New Zealand based fund can then invest into.
16. While it is difficult to measure the behavioural impact, the effect of this would be less GST collected over time. Given the likely transition costs of establishing and domiciling an existing New Zealand managed fund in another country, or to reinvest a managed fund into an overseas fund, we believe it is unlikely a significant number of managed funds will relocate outside New Zealand in the short-to -medium term.

### **Application date**

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17. As noted in the earlier report (IR2022/152, T2022/848 refers), the decision to impose 15% GST would impose significant transition costs for affected<sup>2</sup> fund managers and investment managers. For many of these financial institutions, they are already being required to implement many other regulatory changes, such as the climate reporting disclosures, introduction of the Conduct of Financial Institutions regime, and proposed changes to anti-money laundering rules.

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<sup>1</sup> Management fees are set as a percentage of the fund member's total balance.

<sup>2</sup> Those fund managers and investment managers that are required to transition from a 100% exempt or 90% exempt/10% taxable, to 100% taxable and applying 15% GST to all fees.

18. Of the transitional costs incurred<sup>3</sup>, the changes to the IT systems (often involving multiple layers of legacy IT systems) are likely to require the most time to prepare and implement the changes, especially for funds owned by banks. This issue is compounded because these financial institutions already have several new high priority regulatory programmes and regimes to implement in the short term<sup>4</sup>.
19. To ensure it is viable for funds and service providers to implement the new GST rules, while minimising the transition costs (as these costs will likely be passed onto fund members, including KiwiSaver members), a reasonable transition period is required.

### **Stakeholder views**

20. Stakeholders have mixed views on the time required to implement the new GST rules. The Financial Services Council have previously told us that impacted service providers and managed funds would require a three-to-five-year transition period, whereas other service providers and funds, who are largely unaffected by the changes, have told us they would expect it would require less time for the industry to implement the new rules.
21. Officials from both the Ministry of Business, Innovation and Employment (MBIE), and the Financial Markets Authority (FMA) have recommended a minimum 3-year transition period. They've told us the scope and pace of regulatory change is already being raised as a significant issue by the NZ financial service industry. We are unable to accurately determine whether the industry has excess capacity to absorb additional regulatory change, in the short-to -medium term.
22. MBIE and FMA note that for larger fund managers, they are facing a significant number of regulatory changes in several areas over the next few years, including banking and insurance regulations, financial advice and cash system changes. The nature of any regulatory change means their business-as-usual operations are disrupted, including their ability to invest and deliver their own product and service innovations that usually benefit their consumers.
23. Previous tax policy changes involving the banking and financial industries have generally had an implementation period of up to two years after enactment, however some projects have grandfathered existing rules for up to five years. Each change and the transition period required have been considered on its merits.
24. Given both MBIE and FMA recommendations align with the industry's view that the new rules change would require minimum three years to implement, it does suggest that a shorter time period would place additional risk, pressure and cost on affected managers and funds to deliver the required changes.

### **Fiscal impact of transitional period options**

25. Other than transition costs, the main trade-off between a two-year transition period and a three-year transition period is that a two-year transition period would start collecting additional GST revenue one year earlier. This results in more revenue falling within the forecast period if a shorter transition period is agreed.
26. The fiscal impact of these options should be considered in light of your wider fiscal and policy objectives.

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<sup>3</sup> These transition costs include IT systems, appoint new service providers or renegotiate commercial contracts, update investor disclosure statements, prepare public communications, and responding to increased contacts from customers.

<sup>4</sup> Including climate reporting disclosures, changes to the anti-money laundering rules, and the introduction of the conduct of financial institutions regime (CoFI).

## **Recommendation**

27. In light of this combination of factors, Inland Revenue recommends you approve an application date of 1 April 2026, providing an approximately three-year transition period after enactment (likely to be before 1 April 2023).
28. Treasury also agrees that a three-year transition period is likely to minimise transition costs for industry on the basis of advice from MBIE and the FMA, but notes that doing so would reduce the revenue gained in the forecast period by around \$220 million. It therefore considers it a more balanced judgement based on whether you weight minimising those transition costs or realising a near-term fiscal benefit more highly.
29. While a three-year transition period is longer than many other tax policy changes that impose implementation costs on affected stakeholders, there are precedents for transition costs involving the banking and financial sector to be considered on their individual merits. These include the 2021 unclaimed monies changes providing a two-year transition period (subject to Inland Revenue approval), 2018 BT investment income changes providing a two-year transition period and the 2010 life insurance reforms were subject to various transitional rules for up to five years.

## **Financial implications**

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30. Since our earlier report, we have further developed our fiscal forecast, including incorporating updated managed fund data and revised assumptions. Further advice is also provided on managing the fiscal impacts against forecasts and allowances.
31. Assuming a two-year transition period, the likely increase in revenue from this change is now \$34 million in 2024/25 and \$225 million in 2025/26, with the revenue impact growing by approximately 10% per annum going forward. With a three-year implementation period, the revenue impact has a similar size and profile, but is delayed by a year.
32. We will immediately recognise the impact on tax forecasts if Cabinet agrees to the policy change. However, we propose to advise on whether to recognise any allowance impacts as part of the process of setting Budget allowances through the Budget Policy Statement. That would allow the allowance impacts of this and other tax policy changes to be considered in aggregate, alongside other economic and fiscal considerations.

## **New data**

33. We have updated our forecast model using recently published Financial Markets Authority managed fund data, for the quarter ending 31 December 2021.

## **Revised assumptions**

34. Currently, some fund managers and investment managers can only claim a certain proportion of the GST incurred on their expenses because most of the fees charged are GST exempt. We believe the remaining unclaimed GST is instead being incurred as a business cost to the manager and consequently charged as higher fees to the managed fund.
35. Under the new rules, managers will be able to claim back all of their GST incurred on their expenses. These additional GST deductions will offset against the GST charged on the fees, resulting in less GST paid to the Crown. The forecast now includes an assumption that managers incur taxable inputs of 20% of the value of the fees they provide to the funds. This assumption was informed by financial

information contained in the 2021 annual report of the Guardians of New Zealand Superannuation.

36. In addition, the original forecasts assumed a 10% per annum growth rate in the value of the affected management fees, which is conservative compared to the 20% per annum growth rate observed between 2018 and 2021. However, the new forecast now assumes a lower 5% growth rate for 2022 to reflect the fact that managed funds have generally experienced strongly negative investment returns for the first four months of 2022.<sup>5</sup> After 2022, a 10% per annum growth rate for fees is assumed.
37. The result of these new assumptions is the additional GST revenues that the proposal would collect have been revised downward, compared to our earlier advice.

### Application date

38. As explained above, we are recommending an application date of 1 April 2026 (36-month transition period). If you agree to this application date, the additional GST will be collected from 1 April 2026 (2025/26). However, if you decide to proceed with an application date of 1 April 2025 (24-month transition period), then the additional GST collected will begin from 1 April 2025 (2024/25).
39. With a 1 April 2026 application date (Inland Revenue, Financial Markets Authority and MBIE recommendation), our current best estimate of the fiscal impact of the changes are the revenue gains shown in the following table:

Vote Revenue Minister of Revenue	\$m – increase/(decrease)				
	2022/23	2023/24	2024/25	2025/26	2026/27
Tax Revenue	-	-	-	37.0	247.0
<b>Total operating</b>	-	-	-	(37.0)	(247.0)

40. As noted above, the revenue impact in outyears would likely grow by approximately \$30 million each year.
41. However, if you decide to proceed with a 1 April 2025 application date, our current best estimate of the fiscal impact of the changes are the revenue gains shown in the following table:

Vote Revenue Minister of Revenue	\$m – increase/(decrease)				
	2022/23	2023/24	2024/25	2025/26	2026/27
Tax Revenue	-	-	34.0	225.0	247.0
<b>Total operating</b>	-	-	(34.0)	(225.0)	(247.0)

42. The same assumptions about the likely growth in the revenue impact would apply regardless of the application date. Projected over ten years, the additional GST collected in the 2031/32 fiscal year is approximately \$400 million, with the revenue impact of the change growing beyond this period.

<sup>5</sup> The total value of funds under management is still expected grow during 2022 and future years because of regular contributions to the managed funds exceed withdrawals.

### Managing against forecasts and allowances

43. There are various options for managing the fiscal impact of these changes, regardless of the application date chosen.
44. Officials recommend not immediately recognising any impact on Budget allowances as a result of this change. Additional tax revenue could allow Ministers to increase spending, pay down debt, or reduce taxes in other areas. We propose to advise on these broader choices as part of development of the Budget Policy Statement later this year, and will incorporate the fiscal impacts of this and other tax policy changes into that advice. This approach is consistent with how fiscally significant tax policy changes have been treated previously.

45. s 9(2)(f)(iv)

46.

### Consultation

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47. The Ministry of Business, Innovation and Employment and the Financial Markets Authority were consulted on the Cabinet paper and Regulatory Impact Statement, including the impacts on investors and the proposed transitional period.

### Next steps

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48. We have attached a draft Cabinet paper and Regulatory Impact Statement that reflects the recommendations in this and the April 2022 reports.
49. If you agree to the recommendations in this report, we recommend you approve and lodge the attached Cabinet paper with the Cabinet Office by 10am, Thursday 16 June 2022, for consideration at Cabinet Economic Development Committee's meeting on Wednesday 22 June 2022. If you agree to an application date of 1 April 2025, we will provide your office with a revised draft Cabinet paper as soon as possible.
50. If Cabinet agree to the policy changes, amendments to the Goods and Services Act 1985 could be included in the upcoming omnibus tax bill which is scheduled for introduction in August 2022.

**Recommended action**

We recommend that you:

1. **agree** to adopt one of these two options in respect of the application date:

*EITHER:*

Option 1: a delayed application date of 1 April 2026 (**approximately 36 months after enactment**) to provide time for affected providers to transition to the new rules. (*Inland Revenue’s preferred option*);

Agreed/Not agreed

Agreed/Not agreed

*OR:*

Option 2: a delayed application date of 1 April 2025 (**approximately 24 months after enactment**) to provide time for affected providers to transition to the new rules.

Agreed/Not agreed

Agreed/Not agreed

2. **note** that Option 1 above has the following estimated fiscal impact within the forecast period, with a corresponding impact on the operating balance and net debt:

	\$m – increase/(decrease)				
<b>Vote Revenue Minister of Revenue</b>	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>	<b>2026/27 &amp; Outyears</b>
Tax Revenue	-	-	-	37.0	247.0
<b>Total operating</b>	-	-	-	(37.0)	(247.0)

Noted

Noted

3. **note** that Option 2 above has the following estimated fiscal impact within the forecast period, with a corresponding impact on the operating balance and net debt:

	\$m – increase/(decrease)				
<b>Vote Revenue Minister of Revenue</b>	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>	<b>2026/27 &amp; Outyears</b>
Tax Revenue	-	-	34.0	225.0	247.0
<b>Total operating</b>	-	-	(34.0)	(225.0)	(247.0)

Noted

Noted

4. **agree** to one of these two options in respect of managing the fiscal impact of the change:

*EITHER:*

Option 1: not to directly recognise any impact on allowances at this time as a result of this change and defer these choices to further advice on the Budget Policy Statement later this year (*The Treasury’s preferred option*);

Agreed/Not agreed

Agreed/Not agreed

*OR:*

s 9(2)(f)(iv)

Agreed/Not agreed


Agreed/Not agreed



5. **authorise** and **lodge** the attached Cabinet paper with the Cabinet Office by 10am Thursday 16 June 2022, for consideration by the Cabinet Economic Development Committee.

Authorised and lodged

s 9(2)(a)



**Stephen Bond**  
Manager, Tax Strategy  
The Treasury

**Graeme Morrison**  
Policy Lead  
Inland Revenue

**Hon Grant Robertson**  
Minister of Finance  
/ /2022

**Hon David Parker**  
Minister of Revenue  
/ /2022



In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

## **GST ON FEES CHARGED TO MANAGED FUNDS**

### **Proposal**

1. This paper seeks the Cabinet Economic Development Committee's agreement to proposed changes to the Goods and Services Tax ("GST") treatment of fund manager and investment manager fees charged to managed funds and retirement scheme funds, including KiwiSaver schemes.

### **Relation to Government Priorities**

2. The Government's Tax Policy Work Programme allocates policy resource to maintaining the tax system to ensure that the Taxation Acts are updated to reflect changes in technology, business practices, jurisprudence or other factors. This supports the health and integrity of the tax system by ensuring that laws work as intended. This proposal is required for these reasons.

### **Executive Summary**

3. Goods and Services Tax is a 15% consumption tax on the supply of goods and services supplied to consumers in New Zealand. However, there are certain types of goods and services that are 'exempt' from GST. That is, GST is not imposed on these supplies. One form of exempt supply is financial services (such as the services managed funds supply to their investors).
4. The current GST treatment of management services supplied to KiwiSaver funds and other managed funds is complex and inconsistent. The GST treatment (that impacts the total price paid) of the services supplied by a fund manager or investment manager to managed funds can range from being 100% GST exempt to 100% subject to 15% GST.
5. These issues have resulted in an uneven playing field which may be distorting competition, leading to higher compliance costs and less GST revenue collected. As well, due to the complexity of the existing law, the various GST practices are not consistent with current GST laws.
6. Submissions received on the February 2020 *GST Policy Issues paper* were mixed, with most favouring their particular existing GST treatment for the whole industry. Some submitters suggested their current industry practice of applying a mix of 90% exempt / 10% taxable (effectively imposing a 1.5% tax on managers' fees) should be retained and legislated for across the industry. Other submitters preferred their current

approach of 100% of the fees being subject to 15% GST being retained and legislated for across the industry.

7. In recent months, my officials have met with key stakeholders such as managed funds (broadly split between larger funds and boutique funds) that will be impacted by any change and private sector GST advisors to discuss potential reform options, including retaining the current industry practices.
8. I am recommending all fund managers and investment managers fees charged to managed funds, including KiwiSaver funds, should be subject to 15% GST. This will provide simplicity and consistency across the industry and ensure there is a fair marketplace that is not distorted by the GST rules.
9. Because the recommended rules will impose GST on fund manager and investment manager fees, and the funds cannot claim back this GST cost as a GST input deduction, it is anticipated that much of this GST cost will 'flow-through' to fund investors in the form of higher fund fees.
10. The recommended rules will adversely impact investors, including KiwiSaver members. For many investors that are investing in managed funds for their retirement, including KiwiSaver members, the result of the recommended rules is they will earn smaller after-fee returns on their investments and, therefore, reduced amounts that are reinvested back into the managed fund to generate future returns and ultimately, diminished future retirement savings. However, the extent to which GST will lead to higher fees for retail investors is uncertain, as the market for manager services is viewed as relatively uncompetitive and managers may decide to absorb some of the cost of GST.
11. The proposed rules will result in approximately \$37 million in additional tax revenue in the 2025/26 fiscal year, increasing to \$247 million in the 2026/27 fiscal year. Projected to over ten years, the additional GST collected in the 2031/32 fiscal year is approximately \$400 million, with the revenue impact of the change growing steadily over the forecast outyears
12. I agree with stakeholders that for most fund managers and investment managers, the proposed rules will impose significant transition costs. I am also mindful that these financial institutions have been asked to implement other regulatory changes in the short-to -medium term. In light of this, I am recommending a 36-month transition period before the new GST rules will apply.

## **Background**

13. Goods and Services Tax is a 15% consumption tax on most goods and services supplied to New Zealand consumers by registered person (such as businesses). To ensure GST is not a cost on business production, businesses can claim GST input tax deductions on purchases of goods and services they use in their business.

14. However, there are certain types of goods and services that are deemed to be exempt from GST<sup>1</sup>. One form of exempt supply is financial services, such as those services KiwiSaver schemes and other managed funds supply to their investors.
15. The current GST treatment of management services supplied to KiwiSaver schemes and other managed funds is complex and inconsistent. The pricing of the management services supplied to managed funds can distort competition, lead to higher compliance costs, and less Crown revenue.

#### **Complexity and inconsistency of the existing rules**

16. KiwiSaver and other types of managed funds purchase three main types of services from third parties:
  - 16.1 Fund manager services. A fund manager has overall responsibility for managing the fund. This can include offering and issuing units in the fund to investors, managing the fund's investments, reporting to investors, and procuring services from an investment manager and various administration service providers.
  - 16.2 Investment manager services. An investment manager recommends which assets (such as shares, bonds, cash) or other funds the fund invests into. When reporting to investors, manager services and investment manager services are both reported as "management fees" which are set as a small percentage (typically between 0.2% and 2%) of the funds under management.
  - 16.3 Various administrative services. These include legal, accounting, ICT (information and communications technology) or reporting services.
17. Managed fund fees charged to investors can have a large impact on the financial wellbeing of investors as they directly contribute to the level of accumulated savings, including retirement savings from retirement schemes (such as KiwiSaver). Generally, fees should decrease over time through economies of scale as the amount of funds under management grow and the benefits are passed onto consumers. For this reason, the Government (through the KiwiSaver default provider appointment process) and the Financial Markets Authority have focused in recent years on ensuring fund investors (including KiwiSaver members) receive value for money.
18. Providers of these fund manager and investment manager services apply GST inconsistently, resulting in an uneven marketplace across the industry.<sup>2</sup>

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<sup>1</sup> Meaning GST is not charged on the good or service, but also the business cannot claim back GST charged on the costs incurred to supply that exempt good or service. These supplies are known as being 'input-taxed' because the GST charged on these purchases is collected and not claimed back.

<sup>2</sup> Unlike many other industries, any GST applied to these services represent a real cost for managed funds. This is because under New Zealand's GST rules managed funds are 'exempt' from GST. They cannot claim back GST charged to them, and do not apply GST to the fees they charge to investors.

19. The industry applies the following GST practices:
  - 19.1 For retirement schemes, an existing **GST exemption** applies for management services provided directly to a retirement scheme. However, this exemption is limited.<sup>3</sup>
20. For other types of managed funds, the GST treatment is usually by either:
  - 20.1 The largest fund managers and investment managers typically treat 10 percent of their services as being subject to 15% GST and the remaining **90 percent as GST exempt**. This is because they consider their services are mostly “arranging” the buying and selling of investment products and so most of their service should qualify for the GST exemption for financial services. Because their fee is effectively only subject to 1.5% GST, this approach may allow them to charge lower fees to the wholesale managed funds.
  - 20.2 A group of boutique fund managers and investment managers apply **15% GST to all of their services**. This is because they consider their services are providing investment advice and other types of services that are typically subject to 15% GST. This approach means the managers can claim GST deductions on their purchases. This may be because they have fewer ‘in-house’ resources, compared to the larger fund managers and investment managers.
21. Many of the industry’s current GST practices, such as 90% exempt, are not consistent with existing GST law. However, up until 2014 these positions were accepted by Inland Revenue as part of an industry agreement. However, in 2017, Inland Revenue formally considered how the GST should apply to these fees under existing law, with the draft conclusions further complicating the issue. This means that even retaining the status quo industry practices would require amendments to the GST Act.
22. The problem and several potential policy solutions have been subject to ongoing consultation with the industry, including the issue being subject to public consultation in *GST Policy Issues: an officials’ issues paper* released in February 2020. Overall, submitters’ views were mixed on what the preferred solution should be, largely depending on their current approach to GST.
23. Following public consultation, my officials continued to engage with industry representatives. The Financial Services Council (which represents most of the large managed funds managers) raised a new preference to effectively legislate the status quo. This approach would involve a fund manager or investment manager choosing their preferred GST treatment, based on one of three available options. It would allow the current, inconsistent GST practices of all three GST treatments to continue. However, the option would avoid any transition costs or other costs which could otherwise require managed funds to charge higher fees to investors, such as KiwiSaver members.

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<sup>3</sup> This exemption does not apply where a retirement scheme invests into an underlying wholesale managed funds, as the managers and investment managers will be providing their services to the wholesale fund, rather than the retirement scheme.

24. A law change is required to resolve the legislative uncertainty that is impacting the managed funds industry.

### **Services supplied by fund managers and investment managers subject to 15% GST**

25. I recommend that all fund manager and investment manager fees charged to managed funds should be subject to 15% GST. This includes fund manager and investment manager fees charged to retirement schemes.
26. This proposal is consistent with associated GST frameworks and principles, in particular the financial services exemption, which should generally be limited to cases where there are valuation issues.
27. This proposal will result in competitive neutrality across the managed funds industry with all fund manager and investment manager suppliers competing fairly in the marketplace. All their manager fees would be subject to 15% rather than some being treated as exempt or 90% exempt (effectively 1.5% GST). As well, general managed funds and retirement schemes that invest into underlying wholesale funds would no longer be disadvantaged when compared to retirement schemes that procure management services directly. The fund managers and investment managers that are currently charging 15% GST on their fees would not be impacted by the proposed changes.
28. By requiring the same GST treatment across the industry, fund managers and investment managers will have simplified GST compliance as they would be able to claim GST deductions for all the GST charged on their external costs. There will be less risk of errors or tax disputes on the GST treatment of services provided to managed funds.
29. Compared to the other options, this proposal is more sustainable in the long term, as there is likely to be less pressure for further exemptions or pressure on the legislative boundary and novel interpretations of the rules in an attempt to obtain a GST advantage over competitors.

### **Impact on retail fees charged to investors**

30. The proposed rules seek to impose 15% GST on fund manager and investment manager fees charged to managed funds, however the managed funds remain subject to the financial services exemption and so cannot claim back this GST cost. Therefore, it is expected that the additional GST collected will flow through as an additional cost to a managed fund and therefore higher fees for its retail investors, such as KiwiSaver members. Officials from the Financial Market Authority are also of the view that the increased costs of GST will be passed onto KiwiSaver members in the form of increased fees. This increase is counter to recent years where KiwiSaver fees have fallen by 0.15% or 15 basis points over the past two years.
31. The extent to which GST will lead to higher fees for retail investors is uncertain. The economic literature<sup>4</sup> for other types of GST increases and decreases has found they

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<sup>4</sup> IHS (2011), "The Effect of VAT on Price-Setting Behaviour" in IFS et al., A retrospective evaluation of elements of the EU VAT system, Report prepared for the European Commission, TAXUD/2010/DE/328.

are more likely to affect the prices paid by consumers (in this case, retail investors) in more competitive markets, or if the GST reform is broader.

32. New Zealand's managed fund fees are regarded as being less competitive (that is, we have higher fees) than other countries. This could suggest that some funds may be able to offset or absorb some of the additional GST cost pressures by changing their commercial practices, or reducing their profit margins, rather than raising their fees by the full amount of added GST. This is because in more competitive markets, businesses have lower profit margins so are less able to absorb cost increases as an alternative to increasing their retail prices.
33. Because management fees are set as a percentage of the member's total balance, retail investors (such as KiwiSaver members) with higher balances and those invested into higher fee funds would likely face larger increases in fees and therefore reductions in their future fund balances. We expect this change to have a greater direct impact as a share of retirement income on wealthier New Zealanders, who are more likely to have larger savings, including savings in managed funds. However, for some retail investors (such as KiwiSaver members) with low total savings, while the impact as a share of their total retirement income will be lower, the importance of these savings to meet future living costs during retirement means the impact of increased fees may have a disproportionate impact on their living standards in retirement. This is illustrated in the appendix.
34. Stakeholders have mixed views on the level of fee increase as a result of the GST change. The large managed fund providers (that are currently 90% exempt / 10% taxable) represented by the Financial Services Council believe the full GST cost will be passed through to retail investors, whereas the boutique funds believe the additional GST cost may have little impact fees charged to retail investors due to increasing pressure to compete on investor fees.

#### **Stakeholder views on the proposal**

35. While stakeholder views have been mixed, they can be broadly be regarded as:
  - 35.1 The large managed funds, represented by the Financial Services Council, consider the proposal to be their least preferred option, as it would require them to shift from a fully exempt or 90% exempt treatment to 15% GST applying to all fees. Their most preferred option is legislating the status quo. They believe this option imposes the least transition costs and on-going costs on managed funds and consequently, their fund investors.
  - 35.2 The boutique managed funds (which are much smaller in comparison), consider the proposal to be their most preferred option, as it provides a level marketplace with their competitors, while imposing no transition costs or on-going costs on themselves.
36. Alongside this, stakeholders have suggested the proposed changes may encourage a behavioural change in some managed funds, in that they may relocate their funds offshore to avoid incurring GST on the fund manager and investment manager fees charged. This is because GST is not collected on services supplied to offshore domiciled funds, which a New Zealand based fund can then invest into.



37. While it is difficult to measure the behavioural impact, the effect of this would be less GST collected over time. Given the likely transition costs of establishing and domiciling an existing New Zealand managed fund in another country, or reinvest a managed fund into an overseas fund, it is not anticipated that a significant number of funds will relocate in the short to medium term.

#### **Transitional costs**

38. The proposal to charge 15% GST on all fund manager and investment manager fees would consequently impose significant transition costs for fund manager and investment managers that are not already applying 15% GST.
39. The Financial Services Council advise that the proposed rules will impose significant transition costs and have submitted that they would require a three-to-five-year transition period. There are currently over 1,000 funds<sup>5</sup> offered to retail investors. Nearly all of these funds will need to amend their IT systems, appoint new service providers, or renegotiate commercial contracts, update investor disclosure statements, prepare investor communications, and staff training to respond to increased investor contacts.
40. In particular, the changes to the IT systems are likely to require the most time to prepare and implement (especially for funds managed by banks). This is because these financial institutions have much of their IT resources pre-committed to other projects. This includes implementing other required regulatory changes, such as climate reporting disclosures, changes to the anti-money laundering rules and the introduction of the new regulatory regime covering the conduct of financial institutions (CoFI).
41. To ensure funds and their service providers have sufficient time to implement the proposed new rules, I recommend providing a transition period between enactment of the law change and the application of the new rules. I recommend 36 months is provided for this.

#### **Revenue collection**

42. The proposed rules will result in approximately \$37 million in additional tax revenue in the 2025/26 fiscal year, increasing to \$247 million in the 2026/27 fiscal year. Projected to over ten years, the additional GST collected in the 2031/32 fiscal year is approximately \$400 million, with the revenue impact of the change growing steadily over the forecast outyears.
43. The forecast is based on December 2021 data published by the Financial Markets Authority about the manager's basic fee for each KiwiSaver and non-KiwiSaver fund. There are several key assumptions underlying the revenue forecast. These include:
- 43.1 That all, or nearly all of the additional GST will ultimately be passed on to fund investors, including KiwiSaver members.
- 43.2 Management fees charged to fund investors will continue to grow at 5% for 2022 and 10% per annum thereafter. This assumption is based on the dollar value of

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<sup>5</sup> 331 KiwiSaver funds (operated by 39 KiwiSaver schemes) and 758 non-KiwiSaver managed funds.

basic manager's fees on KiwiSaver and Non-KiwiSaver managed funds growing by an annualised average of 20.6% for the three years between 31 December 2018 and 31 December 2021. A more conservative assumption of 5% for 2022 and 10% per annum for later years was used to account for recent investment returns which have been historically high, while the first four months of 2022 had negative investment returns, and that future contributions to KiwiSaver and other retirement schemes may be less as more investors reach retirement age.

43.3 That a manager currently incurs taxable inputs of 20% of the value of the management services they provide. In the future, a manager could claim the additional GST input deductions on their expenses and offset these deductions against the GST charged on their fees, resulting in less GST paid to the Crown.

43.4 The forecast does not consider any other second-order effects.

### **Implementation**

- 44. The proposed rules do not create any material implementation costs to Inland Revenue.
- 45. The proposed rules will impose transition costs on affected fund managers and investment managers. These are outlined above.

### **Financial Implications**

- 46. The proposed rules will result in approximately \$37 million of additional tax revenue in the 2025/26 fiscal year, increasing to \$247 million in the 2026/27 fiscal year. Projected to over ten years, the additional GST collected in the 2031/32 fiscal year is approximately \$400 million, with the revenue impact of the change growing steadily over the forecast outyears.
- 47. The additional GST revenue collected will not be directly recognised on allowances and instead will 'flow-through' to future tax revenue forecasts. The Treasury will advise Ministers on the impact of this additional tax revenue alongside other economic and fiscal considerations when setting future allowances.

### **Legislative Implications**

- 48. Implementing these proposals requires changes to the Goods and Services Tax Act 1985.
- 49. If approved, I propose including the legislative changes resulting from these recommendations in the upcoming omnibus taxation bill, scheduled for introduction in August 2022.

### **Impact Analysis**

#### **Regulatory Impact Assessment**

- 50. The Quality Assurance reviewer at Inland Revenue has reviewed the regulatory impact assessment prepared by Inland Revenue and associated supporting material, and:

- 50.1 The Quality Assurance reviewer at Inland Revenue has reviewed the *GST on management services supplied to managed funds* Impact Summary and considers that the information and analysis summarised in it meets the quality criteria of the Regulatory Impact Analysis framework.
- 50.2 This issue has been subjected to wide consultation, including through a public issues paper. As identified in the Key Limitations or Constraints on Analysis section, a difficulty with assessing the revenue implications of the various options has been establishing the managed funds' likely responses/behavioural changes to GST changes, and the extent to which deductions are currently being claimed on the various input costs associated with providing management services to the managed funds.

#### **Climate Implications of Policy Assessment**

51. The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

#### **Population Implications**

52. There are no population implications arising from these proposals.

#### **Human Rights**

53. The proposal does not give rise to any human rights implications.

#### **Consultation**

54. The initial problem definition and proposed rules were consulted on as part of the release of the *GST Policy Issues: an officials' issues paper* in February 2020. Officials received 11 written submissions on the proposals. Stakeholder views were mixed
55. The large managed funds (represented by the Financial Services Council) view the proposal as their least preferred option, as it would apply 15% GST to the fund manager and investment manager fees charged to their managed funds. Their preferred option is legislating the status quo, as this will impose no material transition costs and no additional cost on their fund investors.
56. However, the boutique managed funds (which are much smaller in comparison) prefer the proposed rules, as they believe these rules will provides a level marketplace with their competitors.
57. The Treasury, the Ministry of Business, Innovation and Employment, and the Financial Markets Authority were consulted throughout the policy development process and in preparation of this paper.
58. The Ministry of Business, Innovation and Employment considers the proposal will have a significant impact on the fees paid by retail investors in managed funds and therefore investment savings outcomes over time, notably in KiwiSaver. Investment fund fees in KiwiSaver are highly relevant when research shows there are issues around retirement savings adequacy for many New Zealanders. While MBIE acknowledges some

inconsistency and complexity with the status quo, the impacts of these are not clear and should be weighed carefully against the likely significant costs of the proposal.

59. The Financial Markets Authority notes that value for money in the fund management sector has been a significant area of its focus in recent years. Overall, fees for KiwiSaver schemes have fallen by 0.15% or 15 basis points over the past two years. The Financial Market Authority's view is that the increased costs of GST will be passed onto members in the form of increased fees.
60. Modelling by the Financial Markets Authority shows that the proposed approach will lead to KiwiSaver fund balances being reduced by \$103 billion by 2070 (KiwiSaver balances of \$2,196.9 billion), while fund balances for non-KiwiSaver managed funds would be lower by \$83 billion (fund balances of \$1,757.05 billion).

### **Communications**

61. I will make an announcement on the contents of the Bill, including this proposal, when the bill is introduced. A commentary on the Bill will also be released at this time. Inland Revenue will include details of the new legislation in a *Tax Information Bulletin* after the Bill is enacted.
62. Some managed funds, as well as their fund managers and investment managers will oppose the proposed rules as the additional GST cost charged to them will be an increased cost to their business (because this GST cost cannot be claimed back). This will likely result in a mix of the fund manager and investment manager absorbing a portion of the GST cost due to commercial pressure, and a portion of the additional GST cost flowing through for retail investors, such as KiwiSaver members, in the form of higher fees.

### **Proactive Release**

63. I propose to delay the proactive release of this Cabinet paper, associated minutes, and key advice papers with appropriate redactions until the introduction of the bill. The expected introduction date for this Bill is August 2022.

## Recommendations

The Minister of Revenue recommends that the Cabinet Economic Development Committee:

1. note that the current rules are creating complexity and inconsistency across the managed funds industry.
2. agree to provide consistency by requiring fund manager and investment manager fees to be subject to 15% GST.
3. agree that the recommendation apply from 1 April 2026 (approximately 36 months after enactment).
4. note the recommended changes will adversely impact KiwiSaver members by reducing their retirement savings in both KiwiSaver schemes and non-KiwiSaver funds, which investors may have invested in to save for their retirement.
5. note the recommended changes has the following estimated fiscal impact within the forecast period, with a corresponding impact on the operating balance and net debt:

	\$m – increase/(decrease)				2026/27 & outyears
	2022/23	2023/24	2024/25	2025/26	
<b>Vote Revenue Minister of Revenue</b>					
Tax Revenue	-	-	-	37.000	247.000
<b>Total Operating</b>	-	-	-	(37.000)	(247.000)

6. agree not to directly recognise any impact on allowances at this time as a result of this change.
7. note that officials will report back when developing the Budget Policy Statement with further advice on managing the aggregate effect of recent tax policy changes.
8. agree the legislative amendments to the Goods and Services Tax Act 1985 required to give effect to the recommended changes in this paper be included in the next omnibus tax bill currently scheduled for introduction in August 2022.
9. authorise the Minister of Revenue, in consultation with the Minister of Finance, to make final policy decisions, in line with these recommendations.

Authorised for lodgement

Hon David Parker  
Minister of Revenue

## **Appendix 1 - Illustrative examples of potential upper-limit impacts on fees and future balances**

Assume the fund is purchasing management services which are currently treated as being 90% exempt, 10% subject to GST (GST is effectively 1.5% on management services) and that management fees comprise 90% of the fund's total fees (the other 10% are administration fees).

Also assume the retail investor's balance grows by 5% in 2022 and 10% each year thereafter (before fees) as they continue to regularly contribute funds and reinvest returns.

### ***Investor with \$37,500 in a fund with a 0.8% annual fee***

A retail investor with \$37,500 invested in a fund that charged a 0.8% fee under the status quo (option 1) would currently pay a \$300 annual fee. Under the proposed reform (option 2), and assuming the GST costs were fully passed through to the retail investor, their fee could increase by up to \$29, to become \$359 for the first year after the reform.

After 25 years of regular contributions and reinvesting, the investor would have had a \$338,530 balance under the status quo and a \$332,040 balance under the proposed reform, a reduction of \$6,490.

### ***Investor with \$100,000 in a fund with a 1% annual fee***

A retail investor with \$100,000 invested in a fund that charges a 1% fee would pay a \$1,000 annual fee under the status quo. Under the proposed reform, their annual fee could increase by up to \$96, to become \$1,194 for the first year after the reform.

After 25 years of regular contributions and reinvesting, the investor would have had a \$862,308 balance under the status quo and a \$841,128 balance under the proposed reform, a reduction of \$21,179.



# Cabinet Economic Development Committee

## Minute of Decision

*This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.*

### GST on Fees Charged to Managed Funds

#### Portfolio Revenue

On 22 June 2022, the Cabinet Economic Development Committee (DEV):

- 1 **noted** that:
  - 1.1 the current rules relating to the GST treatment of fund manager and investment manager fees are creating complexity and inconsistency across the managed funds industry;
  - 1.2 on 12 February 2020, DEV agreed to the release of an officials' issues paper on GST policy issues, including the issue referred to above [DEV-20-MIN-0005];
- 2 **agreed** to provide consistency by requiring fund manager and investment manager fees to be subject to 15 percent GST;
- 3 **agreed** that the above proposal apply from 1 April 2026 (approximately 36 months after enactment);
- 4 **noted** that the changes proposed above will impact some KiwiSaver members by slightly reducing their retirement savings in both KiwiSaver schemes and non-KiwiSaver funds, which investors may have invested in to save for their retirement;
- 5 **noted** that the proposed changes have the following estimated fiscal impact within the forecast period, with a corresponding impact on the operating balance and net debt:

	\$m – increase/(decrease)				
Vote Revenue Minister of Revenue	2022/23	2023/24	2024/25	2025/26	2026/27& outyears
Tax Revenue	-	-	-	37.000	247.000
Total Operating	-	-	-	(37.000)	(247.000)

- 6 **agreed** not to directly recognise any impact on allowances at this time as a result of this change;
- 7 **noted** that officials will report back when developing the Budget Policy Statement with further advice on managing the aggregate effect of recent tax policy changes;

- 8 **agreed** that the legislative amendments to the Goods and Services Tax Act 1985 required to give effect to the above paragraphs be included in the next omnibus tax bill, currently scheduled for introduction in August 2022;
- 9 **authorised** the Minister of Revenue, in consultation with the Minister of Finance, to make final policy decisions, in line with the above paragraphs.

Janine Harvey  
Committee Secretary

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**Present:**

Hon Grant Robertson (Chair)  
Hon Dr Megan Woods  
Hon David Parker  
Hon Poto Williams  
Hon Damien O'Connor  
Hon Stuart Nash  
Hon Michael Wood  
Hon Meka Whaitiri  
Hon Kieran McAnulty  
Rino Tirikatene, MP  
Dr Deborah Russell, MP

**Officials present from:**

Office of the Prime Minister  
DPMC