

New Zealand Society of Actuaries (Inc)

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Taxation of Investment Income
C/o Deputy Commissioner
Policy Advice Division
Inland Revenue Department
P O Box 2198
WELLINGTON

Dear Sir

I am pleased to make this submission on behalf of the New Zealand Society of Actuaries.

The Society is the professional body representing and responsible for the work of actuaries in New Zealand. Many of our members provide advice to clients in this area.

1. Summary

- The current regime for the taxation of investment income is highly anomalous, with many inconsistencies.
- This applies also to the tax regime for superannuation schemes. The current regime is both disadvantageous to lower rate taxpayers and advantageous to higher rate taxpayers.
- We recognise the need to make changes.
- But we note that the changes as proposed need many amendments if they are not to be disadvantageous to the average member of a superannuation scheme. The prime amendments we propose are:
 - The tax applicable to overseas investments needs to be based on less than the 100% of taxable income proposed in order to be consistent with the proposed tax treatment of domestic assets. A percentage of 50% is considered to be more reasonable.
 - To allow Trustees to elect into the new regime for some members and remain on the 33% tax basis for others.
- We separately raise the question of whether or not a separate and distinct tax regime should be enacted for retirement saving with some low level, but real, incentives for saving.

2. Comment

We have chosen to only comment on the issues we see as of prime importance and have not chosen to comment on the detail of the application of the regime. We see this as being better done by the recognised "tax experts".

We note that we only comment on the impact for employer based superannuation schemes.

3. Current superannuation tax regime

The regime has been in place since the late 1980's and is now well accepted. While initially it achieved some element of tax neutrality when the top tax rate was 33% this changed to an advantageous position

when the top rate was increased to 39%. The “favourable” tax position was further enhanced with the decision of the IRD to make certain funds (passive funds) “exempt” from the payment of tax on capital gains.

The current tax regime is clearly disadvantageous to the lower paid, although the regime allows individuals to “shelter” the investment income they earn from the high marginal tax rates applicable on welfare benefits. Currently this situation is not seen as a “problem”, firstly for the reason mentioned above, and secondly, given the low take-up rate on schemes and the predominance of higher rate tax payers in schemes. But this will change with the introduction of KiwiSaver. The issue was highlighted in the Harris Group report last year.

4. Offshore investment tax regime

The proposals to tax all the offshore income at an investor’s marginal tax rate is considered “too onerous”. Such a regime is at variance to the proposed local tax regime and is contrary to the work and proposals made in the Stobo Report. The investment decision of schemes should not be driven by such tax issues and the proposed regime will see superannuation schemes investing less overseas, which will lead to lower overall investment returns to members, and the need, therefore, for individuals to save more for their retirements.

Instead, a rate should be set which is “equivalent” to the effective proposed local rate tax rate allowing for the proposed nil tax on domestic equity capital gains. A base of 50% would be more consistent with the proposed tax treatment of domestic equities.

5. Attribution of income to scheme members

The outcome of adopting an attribution basis is members will be taxed at their applicable marginal rates. This creates real administrative issues for employer superannuation schemes. In most instances an employer’s contributions are not allocated immediately to an employee, and for Defined Benefit schemes none of the employer’s contributions are directly allocated to members. We note the three options put forward in the Discussion Document and have a preference for option three.

For Defined Contribution schemes, income can be attributed to an employee’s account balance and to that part of an employer account, which has vested absolutely to a member. Other amounts in a scheme will need to be taxed at a single rate.

Similarly for Defined Benefit schemes a single rate will need to be applied. Of importance here is that the members will neither “gain” nor “lose” by the rate chosen. The benefit, or otherwise, will flow to the employer funding the scheme.

The question arises as to which rate to use. An average of the marginal tax rates of all the members is considered reasonable.

6. Electing into the regime

We note that, as proposed, a Trustee will need to make a decision on whether to stay with the current regime and a tax rate of 33%, or move to the basis which will tax members at their marginal rate. We further note that the benefits of tax free capital gains on local shares is only “allowed” if the scheme elects into the new regime.

This will create equity issues for Trustees. To surmount these, a scheme should be able to decide to both elect into the new regime for some members and remain with the current regime for others.

We note that a way to achieve the same result is to cap the maximum marginal tax rate at 33%.

7. Separate tax regime for retirement saving

The introduction of Kiwisaver is an encouraging step to promote saving for retirement. It is potentially the forerunner to further initiatives by Government. Explicit savings will be assisted by tax incentives. We therefore note that if the problems as noted above are “difficult” to resolve for superannuation saving then a separate regime should be considered.

A solution to the issues relating to the taxation of investment income for individuals would then be dealt with separately.

We would be pleased to clarify and expand on any of the points made in our submission and able to attend a meeting with officials if this is considered useful.

We look forward to the legislation which will follow from this earlier work and the discussion document, and hope to see a number of significant changes.

Yours sincerely

Mark Weaver

On behalf of the Superannuation and Savings committee of the Society