Tax Working Group Public Submissions Information Release

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23 October 2018

Hon Sir Michael Cullen
Chair - Tax Working Group

Dear Michael

The Tax Working Group has requested feedback on its Interim Report – Future of Tax. This note is my feedback on behalf of the Retirement Income Group Limited (RIG). Specifically, we have provided thoughts on the report's comments on retirement savings.

In the report the Tax Working Group proposes what it terms "modest incentives for retirement savings that is targeted towards low-and middle-income people".

This involves:

- removal of employer superannuation contribution tax (ESCT) for employees earning up to $48,000 per annum
- a five percentage point reduction for each of the lower PIE rates applying to savings in KiwiSaver accounts.

The report also discusses options for taxing KiwiSaver and PIE's if the taxation of capital gains is to be made more comprehensive than is currently the case – the norm rather than the exception as now.

KiwiSaver has proved to be a success in nudging New Zealanders to think about retirement savings and save for retirement in order to buttress the very modest level of retirement income provided by New Zealand Superannuation. The Interim Report sets out how current tax settings produce an adverse environment for retirement savings in New Zealand especially given the fact that we tax nominal as opposed to real income. Given that a person's savings in retirement depends on how much they save in their working life in real terms, taxing nominal income is a considerable penalty imposed on savers.

The proposals above are a modest and indirect means of addressing this problem. It would nevertheless be a welcome measure and I appreciate the need to take into account the fiscal costs of any proposal in this area. Given such constraints, it seems sensible to target what relief can be provided to low and middle income earners and to KiwiSaver.

This is fine in terms of assisting those in work who are saving for retirement. What it does not address are those already in retirement. Much of person's retirement prosperity is dependent not only on how much a person saves for retirement but also how they manage those savings in retirement. The ESCT exemption is of no value to the already retired and restricting lower savings tax rates to KiwiSaver alone would produce a tax incentive locking in the retired to using KiwiSaver as their investment manager.

As noted above, KiwiSaver is a good vehicle for accumulating and managing retirement savings while still working. KiwiSaver schemes manage savings and provide the necessary investment expertise most people lack. Funds are locked in countering the tendency to spend now and worry about the future later. It is not, however, usually the ideal vehicle for managing savings in retirement.

A retired person not only needs investment expertise but also the ability to manage cash flow by spreading withdrawals of capital and income over one's remaining lifetime. This requires, in addition to investment management, expertise in estimating life expectancy, relating that to capital and income withdrawals and managing the risk of wrongly estimating life expectancy. This is very complex for the average individual – even more complex than investment management. In the absence of proper management of cash flows and life expectance risk cover, a retired person is very exposed to substantial risk. If life expectancy is over-estimated, a person will have a much more constrained retirement lifestyle than they could actually enjoy. If life expectancy is under-estimated, a retired person runs the risk of living their last years in very strained circumstances.

The importance of managing retirement savings in retirement is often under-estimated. In the normal course a person will not seriously begin saving for retirement until they are aged over 40 when home and family building combine with peak income earning years providing the financial leeway to save for retirement. They will then save seriously for twenty or so years until they retire. These days they can generally expect to be retired for some thirty years. Thus the years managing savings in retirement can easily be longer than the days saving for retirement. The quality of retirement is as much if not more determined by how retirement savings are managed in retirement as how they are managed as savings build pre-retirement.

It is annuity providers such as RIG that provide the expertise and risk cover for managing funds in retirement. RIG is a PIE but is not a KiwiSaver scheme so its investors (largely retired or soon to be retired) would receive no benefit from the measures proposed by the Tax Working Group. Were those measures to be implemented as set out in the Interim Report then there would be a tax incentive to retain retirement savings in KiwiSaver schemes and forgo the risk and capital management expertise provided by companies such as RIG.

While I agree that tax reliefs in this area should target low and middle income earners, it also seems that the conclusions reached by the Working Group wrongly focus only on those saving for retirement and not those in retirement. I suggest that consideration be given to providing more flexibility and to offer lower tax rates to low and middle income earners who also invest in annuity and similar lifetime income products that specialise in managing savings of those who are retired. In the case of the RIG this would be to allow investors in our product (which provides as one of its benefits annuity cover) to also have a five percentage point reduction for each of the lower PIE rates.

The Interim Report also raises options for taxing PIE's under a more comprehensive taxation of capital gains. The issue is the tax treatment of gains in Australasian shares, any gains on which, under current rules, are tax-free. From RIG's point of view the key issue is that any proposal must be workable at reasonable cost (ruling out the partnership option) and be seen by savers (not officials or economists) as not disadvantageous relative to direct investment in shares or other investment options. It is hard to see how taxing KiwiSaver and PIEs on an accrual basis will meet this requirement. Even with the tax rate adjustments it would be hard to persuade someone that saving in KiwiSaver taxed on accruing gains in shares was not disadvantageous if, as an alternative, they could own shares, never sell them and live off the dividends. Keeping the rules as they now are or other options should continue to be considered.

lifetime
RETIREMENT INCOME

Finally, in the Interim Report the Working Group set out rules for defining and exempting from tax the family home. I just draw to the Working Group's attention that there are a growing number of products internationally that allow the retired to access cash for retirement living from the family home. This includes but is not limited to reverse mortgages. Hopefully more of these products will become available in New Zealand. These can be a good means by which those whose only or main retirement asset is their home. It would be very unfortunate if the family home exemption were designed in such a manner that a person accessing retirement income locked into the family home were precluded from doing so because this would exclude all or some of the home from the family home exclusion. This is a detailed design issue that the Working Group might want to direct officials to explore further.

I thank the Working Group for the very detailed Interim Report. My main issue is that the area of retirement savings and management is a developing one. This should benefit retirees assisting New Zealand manage the demographic bulge of such people we face. New Zealand needs to ensure our future retirees have flexible options and those that best suit their needs. Tax rules that lock us into existing structures are unlikely to produce the best outcome for our retirees. With that in mind I suggest the Working Group review the proposed package of modest incentives for retirement savings set out in the Interim Report and the other issues raised above.

Yours faithfully

[1]

Ralph Stewart
Chief Executive
Retirement Income Group Limited