



*Tax Working Group*  
*Te Awheawhe Tāke*

**Tax Working Group Information Release**

**Release Document**

**February 2019**

**[taxworkinggroup.govt.nz/key-documents](http://taxworkinggroup.govt.nz/key-documents)**

*This paper has been prepared by the Secretariat to the Tax Working Group for consideration by the Tax Working Group.*

*The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the whole Group or the Government.*

*Some papers contain draft suggested text for the Final Report. This text does not constitute the considered views of the Group. Please see the Final Report for the agreed position of the Group.*

**Key to sections of the Official Information Act 1982 under which information has been withheld.**

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;
- [2] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials;
- [3] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions;
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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

# Minutes

Date: Friday 28 September 2018

Location: The Treasury, No 1 The Terrace

Attendees: Sir Michael Cullen (Chair), Geof Nightingale, Joanne Hodge, Kirk Hope, Robin Oliver, Nick Malarao, Craig Elliffe, Marjan van den Belt, Michelle Redington, Bill Rosenberg, Kirk Hope

Independent Advisor: Andrea Black

Secretariat: Paul Kilford, Matt Benge, Emma Grigg, Phil Whittington, Shane Domican, Sam Rowe, Casey Plunket, Matt Cowan, Catherine Milner,

Apologies: Hinerangi Raumati, Michelle Reddington

## 1. Administration

<b>Noted</b>	<ul style="list-style-type: none"> <li>Noted minutes for previous meeting.</li> </ul>
<b>Agreed</b>	<ul style="list-style-type: none"> <li>Group to create updated slides and sent to Secretariat for any tidy ups</li> </ul>
<b>Actions for the Secretariat</b>	<ul style="list-style-type: none"> <li>Look at updating website so can have Secretariat papers by theme searchable on front page</li> <li>Look at providing zip file of Secretariat papers</li> <li>Investigate links to Secretariat papers in PDF version of interim report</li> </ul>

## 2. Portfolio Investment Entity (KiwiSaver and other managed funds) expert advisers

<b>Noted</b>	<ul style="list-style-type: none"> <li>Discussion with expert advisers regarding taxation of Portfolio Investment Entities (notes for this attached)</li> </ul>
<b>Agreed</b>	<ul style="list-style-type: none"> <li>That the main options for taxing most PIEs appear to be either accruals-based taxation with a lower rate, or applying an RFRM/FDR method (although noting that special rules may be needed for property PIEs, listed PIEs or other situations)</li> <li>It is preferable for KiwiSaver schemes to have same tax rules as PIEs so there are harmonised rules</li> <li>Final report to outline that there are potential restrictions on KiwiSaver schemes being able to invest in some types of investments that should be investigated</li> </ul>

<b>Actions for the Secretariat</b>	<ul style="list-style-type: none"> <li>• See whether there are any KiwiSavers that aren't PIEs and if there are any issues with these</li> <li>• Consult further with managed funds industry and report back to Group.</li> </ul>
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### 3. Excluded Home

<b>Noted</b>	<ul style="list-style-type: none"> <li>• Secretariat paper on the Excluded home</li> </ul>
<b>Agreed</b>	<ul style="list-style-type: none"> <li>• Excluded home to include shares in flat owning company, and properties owned by other companies, where the shares are owned by a trust</li> <li>• Agreed to design features outlined below</li> </ul> <p><i>Multiple homes</i></p> <ul style="list-style-type: none"> <li>• Test similar to that used in the Electoral Act to be main tiebreaker where person has multiple homes</li> <li>• If person has two places that meet test in Electoral Act then they can elect which home is to be excluded</li> </ul> <p><i>Māori freehold land</i></p> <ul style="list-style-type: none"> <li>• To revisit this issue following consultation</li> <li>• That issues regarding family home and Māori freehold land are primarily around collectively owned land</li> </ul> <p><i>Relationship where parties have separate homes</i></p> <ul style="list-style-type: none"> <li>• Where people in relationship are genuinely living apart from each other, both can treat their individual residences as main homes so long as both are genuinely their main homes and meet the tests outlined above</li> <li>• Have an anti-avoidance rule to prevent engineering</li> </ul> <p><i>Bridging situation</i></p> <ul style="list-style-type: none"> <li>• People can have two excluded homes for a period where they are living in one home while another is being developed or similar</li> <li>• Period can be 12 months, however to be considered further as part of GTPP</li> </ul> <p><i>Partial use – where property used partly for home and partly for business purposes</i></p> <ul style="list-style-type: none"> <li>• If property is used more than 50% as their home then person can choose to either: <ul style="list-style-type: none"> <li>○ Treat the whole property as excluded from taxation on sale, and not claim any deductions for holding costs of property</li> <li>○ Exclude from tax only the proportion that is used for their home from taxation on sale. The proportion used for business purposes is taxable on sale and holding costs relating to the area used for business purposes are deductible</li> </ul> </li> <li>• Where property is used less than 50% as their main home, the person can choose to apportion the part used for their home and have this treated as exempt from tax on sale</li> </ul> <p><i>Boarders</i></p> <ul style="list-style-type: none"> <li>• Principle should remain that if not taxable on sale then person should not be able to claim deductions for holding costs</li> </ul>

	<ul style="list-style-type: none"> <li>Detail of how to treat boarders to be considered as part of GTPP</li> </ul> <p><i>Change of use</i></p> <ul style="list-style-type: none"> <li>Where there is a change of use of property, to take the “valuation approach” where property is valued at the time of the change of use. Gain during period house is used for non-excluded purpose is taxable on sale.</li> <li>Gains will not be taxed until actual sale.</li> <li>Secretariat to provide further information on valuation methods as part of valuation paper</li> </ul>
<b>Actions for the Secretariat</b>	<ul style="list-style-type: none"> <li>Update draft final report text to reflect decisions above as well as the following: <ul style="list-style-type: none"> <li>Change names used in example scenarios</li> <li>Paragraph 5 – third bullet point “a beneficiary of the trust who <i>becomes</i> irrevocably entitled to the property”</li> </ul> </li> <li>See if there is any data available on how many people own baches in New Zealand</li> </ul>

#### 4. Final Report: Initial thoughts on outline

<b>Noted</b>	<ul style="list-style-type: none"> <li>Initial thoughts on outline</li> </ul>
<b>Agreed</b>	<ul style="list-style-type: none"> <li>Volume 1 and Volume 2 to be collapsed</li> <li>Not provide analysis on issues Group will not be considering further. Instead to outline recommendations and refer to interim report</li> <li>Consider moving retirement savings and housing affordability as part of chapter on extending taxation of capital income</li> <li>Final report to outline potential package(s) with distributional analysis</li> </ul>
<b>Actions for the Secretariat</b>	<ul style="list-style-type: none"> <li>Provide updated final report outline</li> </ul>

#### 5. Revised proposed forward agenda

<b>Noted</b>	<ul style="list-style-type: none"> <li>Secretariat proposed forward agenda</li> </ul>
<b>Agreed</b>	<ul style="list-style-type: none"> <li>For agenda item on land taxes and land banking – consideration of these issues through considering draft wording for final report outlining that Local Government already has power to impose these taxes and it is something for Local Government to consider further use of to assist with housing affordability</li> <li>To ask Statistics New Zealand about potential sources of wealth data</li> </ul>
<b>Actions for the Secretariat</b>	<ul style="list-style-type: none"> <li>As part of RFRM advice to look at rules used in Netherlands. Craig Elliffes book contains information that could be used for this.</li> <li>To see if there is any data available about how much of an issue vacant land is</li> <li>Provide draft final report text on land taxes and land banking</li> </ul>

## **Portfolio Investment Entity expert advisors**

### ***Basic principles of PIE taxation applicable to ETCI***

- PIEs should be treated like they are a direct investment by individuals (or other entity as applicable)
- However, for administration purposes, and to reduce overall compliance costs tax is paid for by a PIE and is like a partnership
- Tax being paid for by a PIE helps to achieve goal of NZ tax system of having as few individuals as possible filing income tax returns

The current rules already strike a balance between neutrality and administration and compliance costs. For example PIEs have different treatment of financial arrangements and FDR rules compared with individuals.

### ***Timeframe for implementation***

Applying ETCI to PIEs will require system changes for PIEs that will take time to implement. PIEs will not have certainty to implement these changes until after the 2020 election. As a result, a possible deferral should be considered for PIEs to give time to implement.

### ***Further consultation***

More consultation is needed with the PIE industry. In particular regarding the workability and feasibility of options, and how easy they will be for clients to understand. In consultation, we should expect differing responses from different PIEs.

### ***Australian experience***

Recommend against following rules similar to Australia. Australia has high compliance costs, and there is an industry set up to manage the complexity of their rules. Need to balance the need for “accurate” rules against the cost of complexity.

### ***What options are there?***

Goal of options are to meet principles outlined above. We want neutrality between investments held by different methods as well as wanting to avoid complexity. An appropriate balance of needed

### ***What do PIEs hold?***

The majority of PIEs hold financial arrangements and shares. A number of PIEs hold solely financial arrangements due to being default KiwiSaver schemes. A number of PIEs only hold international shares subject to FDR. As a result, an ETCI will only affect the subset of PIEs that hold Australasian shares.

A small number of PIEs hold real property investments. However, these are the minority and instead should treat them as a special case when designing rules.

A number of KiwiSaver PIEs invest through non-KiwiSaver PIEs.

PIEs do not generally invest in venture capital, although some do invest into private equity. The key issue stopping investment in venture capital is that PIEs have investors leaving, entering and increasing their investment constantly and so need to be able to value their investments and need to have liquidity to deal with exits.

For some large funds they are able to make relatively small investments into venture capital.

The same issues arise for investments in infrastructure. Although exit issues could be managed if for example, the Super Fund invested alongside them, the difficulty is valuing on a daily basis.

### ***Which method to use to apply ETCI?***

#### ***Partnership/realisation approach***

Taxing on realisation and treating PIE as a partnership is not considered a good option

- Doing so on realisation basis would be incredibly complex, and that most PIEs will not be able to do so on any realistic timeframe
- If the disposal of unit funds is a taxing event it could result in double taxation issues.
- Taxing disposal of unit funds would also require these people to file returns
- Taking the custodian rules as a precedent would have significant compliance costs

Instead main options seem to be either:

- Apply FDR or an RFRM to all share investments by PIEs
- Tax all shares held by PIEs on an unrealised basis (but at a lower rate)
- Tax Australasian shares held by PIEs on an unrealised basis, but apply FDR or an RFRM to international shares.

Accruals and FDR/RFRM are both feasible for PIEs. Main differences are:

- The ability for losses to accrue and be cashed out under the unrealised option
- Accruals will tax people on their actual gains and losses. If a PIE is earning more, would generally be fairer for them to be taxed more (and vice versa)
- FDR/RFRM may be difficult to explain to clients. Experts note there has been issues with clients finding it unfair that they pay tax even when they don't have the cash to pay it

Advisors appeared to prefer accruals option as it would match actual income. However, they noted caution about the treatment of losses.

### ***Accruals option – what rate to apply?***

A lower rate would apply to account for PIEs being taxed on accrual rather than realisation. Different rates could apply depending on the PIEs average holding period, however this was considered to be potentially difficult to communicate to clients.

### ***Share trader anti-avoidance rules***

One additional benefit of taking accruals approach is that it would remove the need for several complex rules in the PIE regime that are intended to prevent traders obtaining the Australasian exemption.

### ***How do imputation credits work for PIEs***

Imputation credits are used by PIE to credit against liability for investors.

### ***Cash PIEs***

Need to consider whether cash PIEs should continue to exist after ETCI introduced.

### ***Real property PIEs***

Might need to do something special for them. The key issue is that real property PIEs hold their assets for a long time.

The publically available real property PIEs are generally listed PIEs. As a result, applying ETCI on a realisation basis is potentially a feasible option as when an investor sells, the price will reflect the deferred tax, as there is a secondary market for units.

There could be complications where there are multiple rates with investors; however this could be managed through an allocation of tax rates based on investor length of holdings.

There are currently real property PIEs holding the land on revenue account. These should be looked at to see how they currently manage the tax liability.

### ***How do PIEs currently make tax losses?***

Financial arrangements, in particular through currency valuations are the main cause of losses.

### ***Should there be an exemption?***

Non-KiwiSaver PIEs should definitely not have an exemption. There is an argument that an exemption for KiwiSaver PIEs could be there as an incentive, however this would mean inconsistent treatment.

There are also some KiwiSavers that are not PIEs.

***Listed PIEs***

One thing that requires further consideration is listed PIEs. Consider whether we want separate rules for them? There are issues regarding listed and unlisted PIEs that need to come back to.