Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

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Tēnā koe e te rangatira Sir Michael

Submission: The Future Of Tax: Submissions Background Paper

ANZ Bank New Zealand (**ANZ**) welcomes the opportunity to submit to the Tax Working Group. We look forward to engaging with the Working Group further on issues raised in our submission. If you wish to discuss any aspect of this submission please contact myself on [1] or [1]

ANZ touches the lives of almost every New Zealander

ANZ is one of New Zealand's largest companies based on profit and assets. With this scale comes responsibility and we take that responsibility seriously. From individuals and family, to the farms and small businesses that are the life blood of our economy, to our largest institutions and corporations, we play a key part in helping New Zealanders achieve their financial aspirations.

Our breadth and diversity is reflected in our people. We employ over 8,000 people throughout New Zealand. They come from a wide range of backgrounds, skills and specialisations and we value the richness that diversity brings to our business.

ANZ is the largest financial institution in New Zealand. The ANZ group comprises brands such as ANZ, UDC Finance, ANZ Investments, ANZ New Zealand Securities, and Bonus Bonds. ANZ offers a full range of financial products and services including a significant range of financial advisory services, personal banking, institutional banking and wealth management services.

ANZ Investments is New Zealand's largest fund manager and manages over $25 billion for over 745,000 investors. It is also New Zealand's largest and most-awarded KiwiSaver manager, with one in four New Zealanders in KiwiSaver investing their retirement savings with us. ANZ Investments is also one of the nine default KiwiSaver managers appointed by the government in 2014.

A long-term focus on financial well-being

ANZ believes that the Tax Working Group should focus not just on the current challenges New Zealand faces, but also on the economic environment of New Zealand beyond the next decade. When considering long term and inter-generational issues, the Living Standards Framework is a valuable lens for assessing tax policy, especially for our social capital. ANZ commits to improving the financial wellbeing of our people, customers and communities by equipping them to be more in control of their money throughout their lives. This means not only their present-day financial situation, but also their ability to achieve financial goals, to have meaningful choices about their future and to be financially stable in the long run. This affects not only our customers and employees but our whole community.

Our submission primarily centres on the taxation of private savings but also briefly covers taxation in light of the changing dynamics of the future labour force. We cover these points briefly below and expand on them in the attached annexes.

More support for private savings is essential

In our view:

- New Zealand has a private savings problem. New Zealanders do not save enough to finance their lifestyle and provide for future financial stability.

- New Zealand does not currently have the correct balance between incentivising individuals to save for themselves and accumulating public savings to provide for those who are unable to save for themselves. We acknowledge any actions need to take account of the fiscal impact of any tax revenue spent or lost on encouraging private savings.

- There is a case to shift New Zealand's taxation policy away from its current TTE model (Tax – Tax – Exempt) towards a ttE model (tax – tax – Exempt). Taxes on individual savings accumulate to high rates over long periods of time, particularly when compared to other forms of investment such as owner-occupied or residential investment property.

- To encourage long-term savings it may also be beneficial to shift towards a model which focuses more on taxing expenditure rather than income.

- New Zealand currently has some concessionary treatment for gains made from savings (the middle T) but ANZ would like to see rates lowered further as this is where individuals can increase their savings the most over time.

- The successful take-up of KiwiSaver shows encouragement is required to ensure that people act in their own long-term best interest. Taxation can provide that encouragement mechanism to change how people save and invest.

- As a result, ANZ specifically supports focussed policies which would encourage long-term savings including:

  - Lower taxation of investment income for savings vehicles;
  - Special savings incentives for low income households particularly focussed on encouraging greater KiwiSaver contributions; and
  - Targeted compulsory KiwiSaver membership (ANZ recognises that there are New Zealanders who are not in a financial position to contribute to KiwiSaver without detrimental effect to their current wellbeing, which is why we would

only support KiwiSaver being compulsory for those over a certain income threshold, but also support other initiatives to assist those who struggle to financially support retirement savings).

- ANZ understands that more work will be needed into the exact design of any measures arising to increase private savings and we would be happy to share further thoughts on these or any other areas.

Different means to achieve private savings goals are possible. Overall, we support recommendations of the Tax Working Group that encourage greater private savings and diversification of investments.

Changing work environment and tax obligations

ANZ recognises that the development of technology and work flexibility is changing the nature of the work environment and, consequently, the labour force. As these working environments change so too will the need for management and compliance with tax obligations.

ANZ sees a key role for banks to play in this future world, working alongside other innovators and Inland Revenue to collaboratively develop simple solutions to promote greater compliance with tax affairs for this changing work environment.

Conclusion

The Tax Working Group has a huge mandate. Your kaitiakitanga function as stewards and guardians of our tax system for future generations is vital.

ANZ welcomes ongoing interaction with the Tax Working Group as your work develops, including making an oral submission to the Working Group.

Yours sincerely

[1]

Philip Leath
General Manager Tax – New Zealand

Annex 1: Private Savings

1.1. New Zealand has a private savings problem

A financial well-being survey conducted by ANZ found that nearly a quarter of New Zealanders have no cash savings and only 23% of New Zealanders surveyed said they have no financial worries.[i] In New Zealand's current climate this is extremely concerning.

- **Affordability:** The current Government is committed to retaining universal superannuation over the age of 65. However, there are questions as to whether this will remain affordable over the very long-term. The New Zealand Superannuation Fund will cover only a small percentage of our future superannuation costs. Increasingly it appears realistic to assume there will be at least some expectation on New Zealanders to provide for their own retirement, particularly for those reaching retirement in the medium to long term. Most New Zealanders will need more private savings to support themselves in their retirement.

- **Lower socio-economic communities:** Looking at financial well-being across our society, those in low socio-economic communities are less likely to have significant savings. These individuals are often unable to save because they have an immediate need for all of their available funds. However, we are concerned that our current regime, which does not provide the necessary support to save, is not preparing people for their future and long-term needs. ANZ believes that we need to adopt measures which specifically target these communities and provide incentives specifically for them to save more.

- **Macro-economic benefits:** Private savings are also important from a macroeconomic perspective. Generally savings are reinvested in the economy in some form, meaning that capital is directed into areas where it is needed and can be most productive. Moreover, private savings levels are important because it means New Zealand is less reliant on foreign capital and this insulates the New Zealand economy from the full force of international shocks.

1.2. New Zealand needs to find the correct balance between private and public savings

Ideally our private / public savings system should be sustainable, with public, private and voluntary pillars.

Given New Zealand's current situation it appears a sustainable system should encourage long-term private savings where possible but also have sufficient public savings to recognise some individuals have no or limited capacity to save and will be reliant on the government to provide for them. A recent study commissioned by New Zealand's Financial Services Council found that nearly all older New Zealanders will be living on the New Zealand Superannuation pension alone after just 10 years.[ii]

- **Upfront fiscal cost:** We acknowledge that many methods to encourage private savings (including those we support) have a fiscal cost, either in terms of less tax revenue collected or in real expenditure. This fiscal cost would be most significant in the short term. However, as savings behaviours change, the resulting build-up of funds put to productive use, including generating tax revenue, should offset this short term cost.

- **Long-term fiscal savings:** Further, in the long term it is likely that the fiscal cost would be offset by a lower need for public expenditure later on. Individuals with greater private savings are less likely to be reliant on government support, particularly in retirement. Moreover incentives to encourage saving have an effect on changing behaviours and habits. This means that over-time people are likely to save more than the incentive requires, as a result of a shift in the culture around saving.

- **Least regrets approach:** A policy which favours private savings is justified on a 'least regrets' basis, as even if it does not achieve all its savings targets, it is the option available to New Zealand with the smallest downside.

1.3. The case for tax changes

New Zealand's current tax system is uniquely biased against long-term savings.

- **Globally unusual approach**: New Zealand is unusual globally, in applying a TTE model to all retirement savings, whereas, most other countries internationally employ either a ttE or EET model. ANZ agrees with the Savings Working Group Report[iii] released in 2010 which considered that a shift away from a fully-taxed TTE model would have benefits for savings in New Zealand.

- **Multiple layers of tax discourage saving:** Under the TTE model savings are effectively taxed three times – firstly when it is originally earned (first T) and secondly taxed on any returns from savings (second T). For long-term savings this gain is partly due to inflation, but is taxed as a nominal gain regardless. The savings are not subject to tax when they are withdrawn (E), but they are subject to GST when they are spent. This encourages people to spend more immediately rather than save long term, as if they spend money immediately it is only taxed when it is earned and when it is spent.

- **Housing relatively tax-preferred:** The gap in the taxation of capital, particularly in favouring the residential housing market also encourages people towards investment in their family home or in investment property rather than other forms of savings.

- **Work towards ttE:** Tax changes can have significant compliance implications, requiring major changes to financial systems. Structural changes to tax treatments (e.g., from TTE to TEE or EET) are not ANZ's preferred approach. There are several ways in which incentives for private savings can be provided within the current framework.

1.4. KiwiSaver appears to be the cornerstone

In terms of take-up, KiwiSaver has been a stunning success. Yet, despite an impressive 2.7 million members and over $40 billion in funds under management[iv], we still have the lowest rate of retirement savings in the OECD[v] and a long way to go to ensure New Zealanders will live comfortably in retirement.

We acknowledge some savings within KiwiSaver are in effect substituting other forms of saving which would have occurred in any event. This does not undermine the case for KiwiSaver: saving for retirement in a well-run diversified scheme is a more attractive model than many other options.

- **Young people favour KiwiSaver:** KiwiSaver is becoming a cornerstone for New Zealanders' savings. More and more young people are starting to feel comfortable with KiwiSaver, have more trust in the industry and see KiwiSaver as the way they will fund both their home and their retirement. This means that getting the right KiwiSaver tax regime, without overcomplicating the system, will become increasingly important for the younger generation.

- **Ongoing government incentives**: So long as KiwiSaver membership and contributions remain voluntary, retaining the existing incentives is necessary to maintain trust in KiwiSaver and ensure its success.

- **Increasing contributions to KiwiSaver:** ANZ supports raising KiwiSaver contribution levels in small but consistent steps (e.g., half a percent per annum) towards a level more comparable to schemes operating in other parts of the world. There should be an option for members' individual employee contributions to automatically increase by small increments up to a capped maximum rate, so that members can feel confident their savings will increase over time.

ANZ cautions that too much tinkering won't help keep confidence in the scheme in the right way, but the right kind of tinkering that gives people the flexibility to be able to save through KiwiSaver to meet their retirement savings goals is encouraged.

1.5. Taxation of contributions to savings

There are a number of policy changes which could be implemented to reduce the effective taxation rate applied to earnings that are contributed to long-term savings (i.e. a move from T to t). Arguably, this increases the incentive for individuals to save because if the money is saved rather than spent, they pay less tax on the savings amount. Even if this does not encourage people to save more in net terms, this does encourage a shift away from investment in the housing market and into more diversified investment products.

Possible considerations for moving towards a smaller 'first t':

1. Reducing the tax rate on contributions to long term savings.

2. Reducing the rate of Employer Superannuation Contributions tax (**ESCT**) applying to employer contributions to KiwiSaver.

3. Targeted encouragement for lower income earners.

These measures have more specific aims – i.e. increasing the percentage of income saved by low-income earners. These mechanisms specifically avoid the issue identified above – i.e. that people may not save more in aggregate, but may just switch between different types of investments.

The fiscal cost of these targeted measures would also be less. However, more importantly these types of measures recognise that there is a specific savings problem amongst lower socio-economic communities and provide solutions specifically designed to address this issue.

Possible ways of increasing savings for these vulnerable groups could include:

i. Reducing the rate of tax on savings contributions over a certain portion of income (for example if a person saves over 8% of their income that savings is taxed at a reduced rate);

ii. Reducing the rate of tax on contributions to long-term savings specifically for low-income earners.

1.6. Taxation of income and gains from savings

Moving towards a smaller 'middle t':

- **Maximum impact:** Adjustments to the taxation of gains on savings would likely have the biggest impact on net amounts of savings overall.

- **Existing 'middle t':** ANZ recognises that New Zealand does already have some concessionary taxation settings savings but we believe that there is further scope for concessionary tax treatment. In particular if a capital gains tax were to be introduced we would support an exemption or concession for gains on certain types of savings.

ANZ supports the following policies to reduce the taxation of income and gains from savings:

1. Only taxing a portion of the income and investment gains on savings;

2. Greater concessionary treatment for long-term investment vehicles such as portfolio investment entities ("PIEs"). This could include reducing the prescribed investor rates ("PIR") available, increasing the taxable income bands for lower PIR and reducing the PIR default rate from 28%. The majority of KiwiSaver funds in New Zealand are invested in PIEs and therefore a change to the taxation of PIE income would have a significant impact for many people. In particular, reduction of tax rates for PIEs could be targeted to those on lower incomes, e.g. reducing or removing PIR on the lowest taxable income bands.

Overall, moving from TTE to ttE increases the overall amount of money people have available to save and increases the value of those savings, increasing both the incentive to save and the benefit from saving.

1.7. Making KiwiSaver compulsory

Whether to move KiwiSaver towards compulsion has been under discussion for the last decade. ANZ believes KiwiSaver membership should be compulsory in a targeted way, in recognition of its role as the third pillar of New Zealand's retirement savings framework.

In the absence of compulsory membership, all those not currently enrolled in KiwiSaver should be automatically enrolled (with an opt-out provision) to capture those who are self-employed, contractors or unemployed.

Rationale supporting this recommendation:

- **Public support:** Research commissioned by ANZ, and conducted by UMR, showed that 60% of respondents say it should be compulsory to join. Of those who said joining should be compulsory, 88% also thought it should be compulsory to contribute if you are earning an income. Of the total population, 53% think contributing should be compulsory.[vi] ANZ recognises that there are some people who are not in a financial position to contribute to KiwiSaver without a detrimental effect to their current wellbeing. This is why we would only support KiwiSaver membership being compulsory for those over a certain income threshold (e.g. some proportion relative to the median household or individual income).

- **Overcoming cognitive bias:** Behavioural observations suggest encouragement is a requirement to ensure people act in their own long-term best interests. Most people suffer from short term bias. They prioritise their current needs and desires over the long term needs. They have overconfidence as to their future financial position, assuming that they will continue to be able to work, will have good health or will change their behaviours and save later on. People also discount the amount of savings they will need in retirement and don't make realistic estimates of how much they need to save now in order to fund their future lifestyle.

- **Cultural shift:** New Zealanders also need a shift in the culture around retirement savings. Compulsory KiwiSaver membership would shift the way people think about retirement savings and savings in general. Prior to KiwiSaver's introduction, only 15% of the New Zealand workforce was enrolled in a workplace savings scheme. Now, there are 2.8 million members, and more than 75% of 18-64-year-olds are enrolled.[vii]

- **Signalling government support of additional voluntary savings:** Positive saving habits mean people are more likely to recognise the long-term benefits of savings and, over time, voluntarily contribute more to their savings. This also means that there needs to be sufficient Government support for the KiwiSaver scheme. We note the change in enrolment numbers following the withdrawal of the kick-start benefit and loss of confidence in the scheme following changes to the member tax credit structure. If KiwiSaver membership and contributions were to remain voluntary, government incentives are crucial to get people to opt into the system and to continue to make contributions. As such, we caution against the removal of existing incentives in the current environment. However, if KiwiSaver were to become compulsory these could be retained or the incentives modified to encourage greater levels of contributions or benefit lower income earners.

  In addition, ANZ believes that KiwiSaver members under the age of 18 or over the age of 65 who are working and contributing should be entitled to the same benefits as other members, including the Government's annual member tax credit and employer contributions. This encourages people to join KiwiSaver at a young age and to form good savings habits early and maintain these throughout their working life.

1.8. Tax treatment for investment in PIEs under a capital gains tax

If New Zealand were to introduce a capital gains tax (**CGT**) ANZ believes that it should be designed to retain current concessionary treatment for gains made by PIEs, as part of encouraging retirement savings. In particular, the current tax exemption relating to capital gains on Australasian shares should be retained for all PIEs and extended to cover Global share gains.

- **PIEs are established savings vehicle:** PIEs (and other similar investment vehicles) in particular, should be supported because they are a proven success in savings management. Professional fund managers have investment knowledge and financial literacy and can be held accountable for their decisions by investors.

Even where investors are financially literate enough to make sound investment decisions, they often prefer to invest in managed funds because they may not want to take the time and effort to make their own investment decisions.

- **Encouraging diversification:** Although it does not guarantee against loss, diversification is the most important component of reaching long-range financial goals while minimising risk. Professional fund managers are more likely to invest in a diverse range of risk investments. The collective structure of a fund means that the fund manager is able to offset the overall risk to the fund with a mixture of different risk investments. Where an investment does not have the expected return, the collective nature of the investment vehicle means that individual investors are insulated from the full financial loss.

- **Balanced approach to risk:** Individual investors are more likely to favour low or medium risk investments. Historically, New Zealanders have favoured property and, currently, 21% of all New Zealanders in KiwiSaver are in conservative funds, indicating that New Zealanders tend to be quite risk averse.[viii] However, from a macroeconomic perspective investment needs to be encouraged in a variety of different sectors and in variety of different risk type activities.

1.9. Inflation and Indexation

Taxing nominal gains is an issue, especially in a low interest rate environment. In theory, tax should only be levied on real gains, not nominal gains so there is no taxation of gains which are solely attributable to inflation.

- **Indexation is too complex:** This theoretical approach would suggest an indexation system, which has the benefit of removing the current detriment of inflation on long term investments / savings. Unfortunately, indexation is highly complex from a compliance perspective and has generally failed when applied to overseas CGTs.

- **Tapering**: Instead, we suggest further investigation of a tapering approach as an approximation to inflation. Tapering is commonly applied in the CGT context, but many of the transactions subject to CGT overseas are within the scope of New Zealand's income tax. Gains on share sales, options and many other financial transactions are all examples.

- **Approximating inflation:** Taper systems can come in many forms, with overseas examples often appearing generous when compared to the inflationary component of a gain. An option approximating to inflation could be to design a taper system with a scale of different rates. For example, an asset held for five years might qualify for say a 10% discount CGT rate and an asset held for 10 years might qualify for say a 25% discount CGT rate. This would allow the taper to more accurately reflect the trend of inflation over time. The taper could be periodically reset approximating to inflation outturns over the holding period.

Annex 2: The changing nature of the working world

ANZ recognises that the world is changing fast. The development of technology together with an increasing awareness by employers of work flexibility is changing how the labour force completes their tasks for New Zealand, and overseas, business. Such changes include the increase of contractors engaging with business in New Zealand (as opposed to the more traditional employee/ employer model) resulting in micro-business models.

ANZ acknowledges that as working environments change so too will the need for management and compliance with tax obligations. This is particularly pertinent for New Zealand's voluntary tax system where a younger generational set may have had very little connection to the New Zealand tax system. However, the obligation to comply with tax obligations remains a fundamental pillar of our society.

ANZ is committed to meeting the needs of our customers and employees as their needs change and develop. However, ensuring tax obligations are complied with in a changing work environment requires a multi-faceted solution.

- **Flexibility:** As the working environment changes we envisage that the tax system will have to become more flexible to deal with the different variety of working situations such as the gig economy and other innovative working arrangements.

- **Role for banks:** ANZ sees a key role for banks to play in the future world, working alongside other innovators. ANZ has been simplifying its product suite to better meet the needs of the mass market in New Zealand. With the growth of accounting and tax technology innovators (such as Xero and MYOB) we consider their skill set may be best placed to ensure greater compliance of tax obligations in the changing work environment through partnership with Banks, rather than Banks becoming tax technology innovators themselves.

- **Solving for the hidden economy:** While ANZ acknowledges that new solutions to promote greater tax compliance are required for the changing work environment, ANZ remains doubtful that this will solve the current non-compliance with tax obligations in the hidden economy. Put simply, people who actively play in the hidden economy simply ignore laws – hence any changes in tax laws and new tax compliance innovations alone will not solve this problem.

- **System changes take time:** The future will likely bring about major systems changes and we look forward to the way ANZ can work alongside tax policy makers and other businesses to help those systems to grow. However, system and process changes at a transactional level will be highly complex (far more complex than any changes to balance flows such as withholding tax on interest). ANZ considers any changes designed to promote greater tax compliance in the changing work environment should be done in partnership with Inland Revenue, the banking industry and tax technology innovators. We would welcome working collaboratively with such parties to conduct thought processes on how to better promote tax compliance across our customer base.

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