

# Women in Super

Wāhine Whakamoamo

PO Box 2656 Wellington

30 September 2005

Taxation of Investment Income  
C/- The Deputy Commissioner  
Policy Advice Division  
Inland Revenue  
PO Box 2198  
WELLINGTON

## **SUBMISSION ON THE TAXATION OF INVESTMENT INCOME DISCUSSION DOCUMENT**

Women in Super wish to submit on the following matters in respect of the Government's discussion document, Taxation of Investment Income, released in June 2005.

### **Removal of taxation of investment gains on New Zealand equities**

Women in Super submit that this proposal is a positive change to provide consistency with New Zealand equities held directly by investors and to recognise that the underlying entity is already being taxed.

Women in Super believe that the proposed exemption from income tax of gains from investing in New Zealand equities should be decoupled from the Qualifying Investment Collective Vehicle ("QCIV") regime. That is, the exemption from tax on gains made from disposing of New Zealand equities should be available regardless of the manner in which the investment is made; whether it is directly held, through a QCIV or through a non QCIV. We believe it is distortionary that QCIV's have such a tax arbitrage and can see no reason why, for example, investors could potentially be taxed on any gain made from the disposal of New Zealand equities that are not held through a QCIV.

We would be very concerned if investors needing to dispose of units in a QCIV at a gain are subject to Inland Revenue review. For example, women who have changes in their personal circumstances (whether it be leaving the workforce for say family reasons, or changes in their family circumstance), may wish to sell units to realise cash rather than wait for distributions. Unless Fund Managers are able to undertake accurate attribution of income on a daily basis, such investors that hold investments in QCIV's on revenue account may be disadvantaged. If the investor waits for the actual attribution they will only be taxed on the entities share of taxable income, specifically capital gains on New Zealand equities will be distributed free from tax, it seems illogical that an investor sells their units before attribution or when a notional calculation is undertaken they could ever face a tax liability on these tax exempt gains i.e. through the taxation of unrealised increases in unit price on the date of realisation.

### **Removal of the grey list**

We submit that this change is inappropriate on the basis that:

It may create a bias towards investing in New Zealand equities rather than a balanced portfolio. Such bias being for tax reasons only as the returns on overseas equities have to be at least 150% to obtain the same after tax returns.

Creating a bias towards one type of investment only increases the risks associated with holding a narrow / unbalanced portfolio.

Where a party undertakes direct investment in "grey list" equities, they will be liable to tax even where there has been no cash flow. That investor may not have the funds available to pay the tax unless part of the investment holding is sold. This may provide a further disincentive from holding such investments as part of a long term savings objective.

The calculation of tax payable under both the comparative value and simplified deemed rate of return method is unnecessarily complicated. This may give rise to increased errors in investors calculating their tax liability and will therefore compound the bias towards investing in other types of investments.

We are concerned that women will only invest in New Zealand equities as opposed to all equities and therefore have sub optimal portfolio construction, namely they will have a narrow scope of investments which will have reduce long terms returns. This seems bad tax policy.

### **Application of "flow-through"**

The requirement for a QCIV to flow-through its income to investors and for tax to be withheld at the investors' marginal tax rates should not be mandatory.

We submit the application of flow-through should be elective on the basis that Women in Super see mandatory flow through as having both positive and negative impacts:

#### *Positive impacts*

Flow through will remove the current "over taxing" that occurs for a number of women due to the nature of employment held. Whereby currently superannuation funds and unit trusts are taxed at 33%, many women are taxed at a lower marginal tax rate due to working part-time and also in lower paid jobs.

Flow through will remove some of the current bias against women investing in such vehicles due to the removal of over taxation. This should have a positive effect on investments and savings as it will provide a greater choice of investment as fund managers elect to be a QCIV to benefit from the new rules.

The suggestion that future losses may be allocated to investor's accounts and carried forward is positive. It will allow those investors' that bore that loss to benefit from its utilisation over the lifecycle of the investment.

#### *Negative impacts*

Flow through of investment income may have a negative impact as it will increase the relevant investors' annual taxable income and therefore increase the tax payable for those investors who are

subject to the 39% tax rate. This will require such investors to restructure their investments so that they are not subject to the 39% tax rate, undertake increasing income splitting via the use of family trust structures through which investments are made or invest into funds that are not QCIVs. If flow through is mandatory, we submit that the maximum tax rate should be 33% on such income to avoid otherwise complex and costly restructuring.

Mandatory flow through may negatively impact on investors where their participation and / or funds on investment are locked into a scheme say until they reached a certain age i.e. retirement. If that fund was to elect into the QCIV regime to take advantage of the income tax exemption on gains from New Zealand equities those investors on the highest marginal tax rate will be disadvantaged as they would not have any choice to move their investment to another say non QCIV fund.

The aggregation of flow through income from QCIVs with source deduction payments may impact on the eligibility of that investor to family assistance, child support etc. This may disincentivise women from investing and saving in QCIVs thereby removing the favourable tax treatment arising from women being in general on lower marginal tax rates. At its most extreme it may disincentivise women from investing and saving which is in complete contradiction to the current Government's push to increase the level of saving. We submit that in NO circumstance should income from a QCIV impact on family assistance entitlement. Investment in QCIVs will generally be long term investment hence the importance that this income not impact on family assistance.

The proposed rules for flow-through will likely increase compliance costs for fund managers that elect into the regime with such additional costs being passed through to investors and negatively impacting on overall returns. We note this however believe that the compliance costs can be reduced by making flow through voluntary.

Investors will be required to provide their marginal tax rates to administrators of QCIVs. Where this is not undertaken before the first attribution it is likely that a default rate will be applied (and likely that this will be the highest marginal tax rate currently 39%). Given the fluidity of women's involvement in the work force, the applicable marginal tax rate may vary within an income year. This may give rise to both over and under taxation. Women would then be required to file an income tax return to have any over taxation refunded. There should be NO penalty for getting this tax rate wrong as is the case for resident withholding tax rate selection. It is totally inappropriate that the member could be subject to penalties (paragraph 4.97) or family assistance abatement (paragraph 4.98). It seems from the discussion document that if the investor chooses a low withholding tax they are subjected to penalties if it is wrong and if they choose a high withholding tax rate they will have this income subjected to family assistance abatement if they seek to recover the over taxation. Again for women who have savings with changing circumstances (entering of exiting the workforce, having families etc) this policy will negatively impact them and defer them from making such investments.

Finally, if flow through were to be mandatory, Women in Super see other forms of investment as becoming more popular especially with those investors on the highest marginal tax rate. Taken to the extreme, such investors may choose to undertake savings in other forms of investment, for example direct holdings in property as when held on capital account there is no tax is payable on any gains on disposition. Should this occur, property prices would continue to rise creating more barriers to first time home owners and for women to the extent they wish to own family homes on a single income.

#### **Elective nature of proposed changes**


The discussion document states that the elective nature of the proposed regime is subject to review. Suggestions have been made that the Government may make the new regime mandatory if superannuation funds deliberately stay out of the new regime to avoid having their investment income being taxed at 39%. This threatened change is untenable as superannuation funds are established as

long term savings mechanisms and the tax rules impact on these decisions. A degree of certainty is expected and required to attract members.

For women who have changing circumstances, given the potential penalties discussed above, they may place savings in non QCIVs to avoid such penalties; it is totally inappropriate for all collective investment vehicles to have such a penal tax regime applied mandatory.

The additional compliance costs that would result from the mandatory application of the new rules will mean that many smaller superannuation funds will also not be viable; we think this to be bad tax policy.

Women in Super believe that whatever the ultimate form of change in this area, that the key issues are that what is adopted must be workable for all of the affected parties including but not limited to, investors, fund managers, the Inland Revenue and other affected governmental agencies and that it results in equitable tax treatment regardless of the type of investor.



On behalf of Women in Super