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Op-Ed for NBR

It's time to remove the "Stealth Taxes" on savings: Savers and business would benefit

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When I was the Minister of Revenue I addressed a number of meetings of people angry that the Labour Government had removed the tax concessions for superannuation savings.

There always seemed to be one smart actuary, accountant or economist in the audience who would say the result would be over-taxation of long term savings. I raised the concern with officials at the time but their answer was that I should tell the audiences it was going to be just the same as taxing money in your bank account.

Unfortunately that was true but also misleading as under our current accrual tax system compounding interest financial products like term deposits and KiwiSaver are both significantly overtaxed relative to other forms of income.

The Fair Tax for Savers Campaign as launched last week (July 30) with a new web site through which people wanting to reduce the world's harshest tax regime on long term savings, can directly e-mail and petition MPs, party leaders and finance spokespeople. Postcards are being inserted in newspapers and the campaign is being bolstered by online advertising. The fair tax proposals would see the average wage earner saving in KiwiSaver receive more than $100,000 extra in retirement.

Someone in the 33% tax bracket with a $100,000 term deposit rolled over during their 25 year retirement would receive more than $19,000 extra income over that period.

The Fair Tax for Savers campaign has asked all political parties to consider removing the over-taxation of longer term savings by:

- Making the effective tax rate paid on KiwiSaver funds the same as the marginal tax rates KiwiSavers would pay on their other income, and
- Taxing term deposits only on the real interest rate (actual interest less the rate of inflation) rather than the nominal interest (the actual interest you receive) as the compensation for inflation is not really economic income.

Most people do not realise they are being overtaxed through these "stealth taxes" and our political leaders have little incentive to change that situation. Our Fair Tax for Savers Campaign aims to lift the covers off this.

The Financial Services Council asked Robin Oliver, the highly respective former Deputy Commissioner for Policy at Inland Revenue and now a Principal at OliverShaw, to prepare a report on the likely fiscal and economic impact of the Campaign proposal to index interest income from term deposits and also index the deduction of interest expense by businesses and other investors. In his report, Robin Oliver concluded that changes to how term deposits are taxed and interest costs are deducted along the lines suggested by the Campaign, would be expected to:

- Increase overall government tax revenue by about $500 million per annum.
- Increase household after-tax incomes by $400m focussed on the retired and those saving for retirement.
- Provide greater incentives for retirement savings and a greater opportunity for New Zealanders to save for a comfortable retirement.
- Discourage highly speculative investments such as investments in rental property, and
- Provide an increased incentive to have term, as opposed to on call, deposits reducing the vulnerability of our financial sector.

The $400 million boost to household after-tax incomes would be significant, a major reward for saving, and result in more productive investment and growth for New Zealand.

There are a number of reasons why Robin Oliver's conclusions differ from the broad estimates officials provided to the Savings Working Group back in 2010:

- The Campaign proposal for interest indexation is restricted to term deposits (usually understood as being lending for 90 days or more) so about one third of interest income would not be indexed with a consequent loss of revenue.
- The over-taxation of interest income in KiwiSaver funds would be fixed by the cut in KiwiSaver fund tax rates so does not need to be compensated for twice.
- Home owners with mortgages are unable to deduct their mortgage interest costs against their incomes so no Government revenue loss has to be funded for this interest cost.
- Non-residents already are taxed at a concessional 15% tax rate under treaty agreements and they would not need to have indexation extended to them as they have a concessional rate already.
- It is also likely that foreign owned corporates would switch their debt funding in New Zealand to have more equity funding in their New Zealand business and more debt sourced from their home country where the interest expense would be fully deductible. This would transfer the revenue cost of the tax subsidy from New Zealand taxpayers to the taxpayers in their home country.

Robin Oliver estimates the overall impact of these term deposit changes would be to increase the New Zealand Government's tax revenue by about $500m.

The KiwiSaver fund tax cuts proposed are estimated by FSC to cost less than $200m if applied this year so the Fair Tax for Savers package would increase Government tax revenue overall.

Over time the cost of the KiwiSaver fund tax rate cuts would rise as the number of KiwiSavers increased and the value of KiwiSaver funds grew based on growing contributions and the reinvestment of fund earnings. Eventually the annual cost of the KiwiSaver fund tax rate reductions would cost more than the indexation of interest income and deductions.

These numbers are all broad estimates. It would be desirable for the Parliamentary Finance and Expenditure Committee, after the election, to hold an inquiry and find out what these changes would cost using the data and input from the finance sector along with the advice from Treasury, IRD, the Reserve Bank and MBIE. The committee could also find out what progress has been made on the recommendations of the 2011 Savings Working Group and the 2013 Retirement Commissioner's Review of Retirement Income Policy to address these issues.

So what are the benefits of these changes for business?

First, overwhelmingly debt funded investments such as in rental property and highly leveraged private equity transactions would no longer be tax subsidised making more capital available to invest in new business assets to grow the economy rather than just bid up the value of existing assets.

Secondly, it would rebalance investment from debt into the equity needed by fast growing New Zealand owned companies that too often are sold to overseas investors before reaching their prime because of restricted access to locally owned equity capital.

Thirdly, it would help reduce the tax paid by most New Zealand businesses because currently New Zealand based but overseas owned corporates are incentivised to maximise their debt levels in New Zealand as they are able to deduct the inflation compensating part of interest which is really a return of capital to the lenders. The removal of this tax subsidy would boost New Zealand tax revenue and provide funding to reduce KiwiSaver fund, corporate or income tax rates.

Fair Tax for Savers proposed reforms would be a game changer for business and substantially reduce the tax bias in favour of investing in land relative to other investments, more likely increase jobs, incomes and our real wealth. A relative of my wife once said while he had been a successful manufacturer his real wealth had come from investing the manufacturing profits in land. How much wealthier would we have all been if people in his circumstances had reinvested in another growing business

- Peter Neilson is Chief Executive of the Financial Services Council. Between 1984-1990 he was Minister of Revenue, Customs, Works and Development and Associate Minister for State-Owned Enterprises and Finance in the Fourth Labour Government. The FSC-led Fair Tax for Savers campaign is supported by aged Concern, Consumer NZ and the Taxpayers' Alliance. www.fairtaxforsavers.org.nz.