

SUBMISSION BY PROPERTY COUNCIL NEW ZEALAND INCORPORATED TO THE SAVINGS WORKING GROUP

PROPERTY COUNCIL NEW ZEALAND INCORPORATED (at the address for service given below) makes the following submission to the Savings Working Group:

BACKGROUND

1. Property Council is a not for profit organisation that represents New Zealand's Commercial, Industrial, Retail, Property Funds and Multi Unit Residential Property Owners. Property Council represents all forms of commercial property and property investment in New Zealand.
2. Property Council actively involves itself with central, local and other government associated bodies, promoting the views, goals and ideas of our members.

TAXATION

3. Property Council strongly agrees with “getting the savings environment” right through having appropriate tax policies to encourage private savings. This is as important a step as the fiscal environment and other Government policies to encourage savings.
4. The introduction of the Portfolio Investment Entity (“PIE”) rules was an important landmark in ensuring that investors using both listed and unlisted savings vehicles were able to receive broadly the same tax treatment as investing directly (i.e. on their own account). The effect of tax distortions on investment via managed investment funds,

and other intermediated vehicles, was discussed in detail in the (then) Government's discussion document preceding the PIE reforms¹:

... The tax barrier to investing via savings vehicles may disproportionately affect lower and middle-income savers as these groups are unlikely to have sufficient funds and expertise to invest directly in a diversified portfolio of assets. For them, savings and investment vehicles may be an important source of portfolio diversification, but one that is currently tax-disadvantaged.

Another cause for concern is the effect of tax distortions on the financial system. The pooling of investment and its reallocation generates a broader range of investments than individuals would generally be able to undertake on their own, providing benefits both to investors and to the economy. Work carried out by the Treasury has highlighted the economic importance of the system of financial intermediation, including its role as a key source of finance for certain types of firms. The existing tax distortions impede the productive use of capital and misallocate investment by discouraging intermediation.

5. While much has been made recently of the difference between the top PIE tax rate (30 per cent, falling to 28 per cent from 1 October 2010) and the top marginal rate (38 per cent, falling to 33 per cent from the same date), with some commentators labelling it a distortion, we believe this "PIE tax benefit" needs to be kept in perspective.
6. New Zealand's entity taxation model has historically "capped" the taxation of investments at 33 per cent, and more recently 30 per cent. Direct investors can and have used trusts (and to a lesser extent companies) to avoid taxation at the top marginal rate on income. The PIE tax rate cap of 30 per cent (soon to be 28 per cent) is simply an extension of this "reality" for direct investors, who are predominantly likely to be higher net worth individuals, to those investing via collective investment vehicles (more likely to be "mum and dad" investors).
7. Property Council is therefore a strong proponent of the PIE regime, as it allows investors who would not otherwise be able to invest in high-quality commercial, retail and industrial property investment directly, to own a part of New Zealand's vital business

¹ *Taxation of investment income*. A Government discussion document. June 2005.

infrastructure, without suffering undue tax disadvantages. Pooling allows diversification of risk and the ability to maximise returns.

8. We are concerned however that the recent negative publicity around the taxation of residential property has resulted in the incorrect perception that industrial, retail and commercial property investment through PIEs is somehow tax favoured. Many investors choose non-residential property as it offers competitive, yet steady, returns over time; not because there is any tax benefit. Therefore, particularly for older New Zealanders, including those in or approaching retirement, the listed NZX property sector offers a compelling alternative to other asset classes.
9. In terms of Property Council's own membership, many of whom are listed PIEs trading on the NZX, we note investment in property assets do not receive automatic capital account tax treatment under the PIE rules (in contrast to, say, NZ equity investments). Further, Government has also recently removed tax depreciation for the non-residential property-owning sector, which has impacted on rental yields. Therefore, in our view, it is incorrect to say the PIE rules offer benefits above those available to direct investors, or investments in other asset classes.
10. The PIE rules simply allow investors to be allocated their share of the income and expenses of the Fund, while accessing any capital gains tax-free; this is how the New Zealand taxation rules would apply to a direct investor. Therefore, we see no compelling difference between the treatment of direct investment in commercial, retail and industrial property, and such investment through PIEs (and property versus other asset classes, such as shares), which would suggest the PIE rules should be removed (either for property holding funds or collective investment vehicles generally).
11. Finally, we believe that the PIE rules are inextricably linked with KiwiSaver, which according to the Treasury Paper has ballooned to nearly 1.5 million members. We believe that the ability to be taxed at investors' personal tax rates (including, importantly, those on lower rates than 30 per cent) has been a key driver of the success of KiwiSaver. We do not believe that it would be sustainable for existing tax features of KiwiSaver accounts to be removed or diluted, if the Government's long term objective is to encourage private savings. Particularly, given the discussion in the Treasury paper

around the savings tax concessions which appear to be available in other jurisdictions, which we discuss below.

12. Instead, we believe the focus should be on creating a tax environment that encourages savings in a diverse range of assets, including commercial, retail and industrial property, as part of a balanced investment portfolio.
13. The Treasury Paper notes on page 40 that: *“Many countries offer tax subsidies that move toward exempt-exempt-exempt (EET) treatment of retirement savings, which substantially reduces the effective tax rate on savings.”* By comparison, New Zealand’s tax-tax-exempt (TTE) structure for collective investment vehicles is uncompetitive and outdated, developed at a time when New Zealand’s tax policy aimed for theoretical, rather than pragmatic, solutions.
14. Even countries which do not operate a full exemption model on investment earnings of investment funds, still offer a more generous tax treatment. For example, Australian collective investment vehicles are taxed on earnings at a rate of 15 per cent within the Fund. Under the PIE regime, New Zealand investors bear a 30 per cent tax liability (lower in some cases) on investment earnings in the Fund. This should put into context the tax “hurdle” currently faced by New Zealand savers, compared to their foreign counterparts. Australia’s success in encouraging private savings (as evidenced by their trillion dollar superannuation sector) is at least partly likely to have been driven by the more competitive tax environment.
15. Property Council does not believe that taxing investment income as it arises is the correct outcome for long-term savings, particularly in property assets, due to both nominal (inflationary) and real gains being subject to tax. This can lead to very high effective marginal tax rates on such investment, as demonstrated in the Treasury paper. We would therefore strongly support moving to an EET model for New Zealand investment funds, including those investing in property.

PROPERTY AS AN ECONOMIC DRIVER

16. The commercial property sector is one of the largest investment classes in New Zealand with commercial property seen as an important part of a diversified investment

portfolio. The listed property sector alone has a market capitalisation of over \$3.6 billion² on the NZX. Commercial property provides a low risk stable income stream for investors and this feature of commercial property investment is fundamental to the wellbeing of the retirement income of a growing number of New Zealanders.

17. It is a well stated objective of Government to improve the poor savings level of New Zealanders and the introduction of Kiwisaver has been a positive step towards achieving this objective. Further, the introduction of portfolio investment entities and changes made to the taxation of equity investments have also been a welcome step towards encouraging savings and investment by New Zealanders.
18. Historically, New Zealanders are poor savers. New Zealand households live in debt, often unserviceable due to its size and scope. As a consequence, many New Zealanders struggle to enjoy the kind of financial security, choice, and independence they'd like. Secondly, the poor savings record of New Zealand households leads into a wider problem that constrains the entire economy: we don't have the domestic cash available to channel through to productive use.
19. Commercial property is the infrastructure of business, and one of the factors of production that is essential to the creation of high-wage, high-skills economy. By way of an example, a 2007 study undertaken by the University of Waikato concluded that total revenue received by the Hamilton property industry for goods and services provided to \$1,322.7 million of which an established 76 per cent was for construction and property management in Hamilton City³. Total direct employment linked to property in Hamilton City was 6,085 persons at the time. However, accounting for backward and forward linkages to other supplying and using sectors associated with the property industry in the Hamilton economy, the total revenue impact of Hamilton's property industry was \$3.3 billion and the total employment impact in Hamilton City was 17,736 persons.

² AMP NZ Office Trust \$848.1m, Kiwi Income Property Trust \$843.3m, Goodman Property Trust \$844.8m, ING Property Trust \$427.4m, Property for Industry Limited \$250.4m, ING Medical Properties \$165.1m, National Property Trust \$96.7m, CDL Investments \$68.1m, Kermadec Property Fund Limited \$42.3m and Apple Fields \$4.0m as at 30 September 2009.

³ *Economic Impact of Hamilton's Property Industry*. University of Waikato, 2007.

20. The property industry is a major driver of economic activity in New Zealand, and in particular in New Zealand cities. The buoyancy of the New Zealand commercial property market is an indicator of national economic activity. The strength of the commercial property sector is also linked to the ability of the economy to generate employment opportunities, both within that sector and with associated firms within that economic supply chain. It is therefore vital that from a national economic perspective, the Savings Working Group submits to the Government policy recommendations that encourage investment in commercial property, which in turn will continue to be a key driver of high-wage and salary employment.

Conclusion

21. Property Council would welcome the opportunity to speak to this submission.

DATED this 30th day of September 2010.

A handwritten signature in blue ink, appearing to read 'Connal Townsend', with a horizontal line underneath.

Connal Townsend, Chief Executive
On behalf of Property Council New Zealand

ADDRESS FOR SERVICE: PO Box 1033
Auckland 1010