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Tax Working Group Secretariat
Wellington
New Zealand

BY EMAIL: submissions@taxworkinggroup.govt.nz

Dear Members of the Tax Working Group

Submission on the Future of Tax: Submissions Background Paper

Thank you for the opportunity to make a submission to the Tax Working Group (the **Working Group**) on the Future of Tax in New Zealand.

We acknowledge the Working Group's mandate as set out in its Submissions Background Paper (the **Paper**) is to examine further improvements in the structure, fairness and balance of the tax system with reference to the impact of the likely economic environment over the next decade.

Introduction to the New Zealand Superannuation Fund and focus of these submissions

The [New Zealand Superannuation Fund](#) (the **Fund**) invests money, on behalf of the Government, to help pay for the increased cost of universal superannuation entitlements in the future. The Fund is managed by a Crown entity, the Guardians of New Zealand Superannuation (the **Guardians**).

As one of the largest taxpayers in New Zealand the Fund is a key stakeholder in the New Zealand tax system.

The Guardian's submission is mainly confined to areas we consider affect the Fund, its investment partners and the citizens of New Zealand entitled to future pension benefits. Our submission is arranged as follows:

- Executive Summary
- Tax profile of the Fund
- Weighing up tax policy proposals
- Appendix I – Response to specific queries raised by the Working Group in terms of the impact on the Fund and on taxpayers more generally; and
- Appendix II - Outline of the Fund's role in contributing to New Zealand's savings and future well-being.

Given the direction in the terms of reference (**TOR**) for the Working Group, this submission does not discuss the adequacy of the personal tax system and its interaction with the transfer system as these will be considered as part of a separate review.

Executive Summary

We are an active member of the Corporate Taxpayer Group (**CTG**). We acknowledge and agree with the positions adopted in CTG submission to the Working Group regarding the importance of providing certainty to taxpayers, keeping tax compliance costs for both taxpayers and Inland Revenue as low as possible and ensuring that our tax system remains competitive so as to support investment in New Zealand and economic growth benefiting all New Zealanders.

General comments:

- *Broad-based, low-rate framework (BBLR)*: We support the continuation of the broad-based, low-rate tax framework.
- *Generic Tax Policy process (GTPP)*: The longstanding GTPP¹ (designed to encourage early consideration of key policy elements and trade-offs of proposals and to provide opportunities for substantial external contribution to policy formulation) is under pressure with some recent reforms appearing rushed and contrary to New Zealand's overall national interest. We encourage a review and refresh of the current process to establish a framework whereby all the Government's policies can be taken into account on an holistic basis when determining whether or not a tax change is in New Zealand's overall long term interest.
- *High hurdle for any new taxes*: There needs to be a "high hurdle" for introducing new taxes outside the current very efficient and effective big three i.e: GST, personal income tax and company income tax. If the Government requires extra revenue then it should be gathered via these taxes.
- *Competitiveness*: Company tax needs to be responsive to changes made by other countries that compete with New Zealand in export markets and in attracting foreign capital.
- *A firm commitment to reducing complexity and compliance costs*: New Zealand tax legislation has become more and more complex which in turn has resulted in the need for continual remedial legislation to cope with unintended consequences. To address this we recommend that Inland Revenue forms a dedicated unit within Tax Policy and Strategy to deal solely with remedial legislation. In addition, we recommend granting the Commissioner the ability to issue determinations and/or regulations (subject to checks and balances) in line with policy intent. This combination of measures would improve the health and integrity of the tax system.

¹ The GTPP is an approach to developing tax policy used since 1995 that aims to ensure effective tax policy development through early consideration of key policy elements as well as revenue impact, compliance and administrative costs and economic and social objectives. Consultation and feedback are integral parts of the process. For more detail > <http://taxpolicy.ird.govt.nz/how-we-develop-tax-policy>.

- Measuring Inland Revenue performance: We recommend a change from the traditional measurement based almost entirely on tax adjustments (which drives undesirable behaviours in some) to a focus on providing certainty, educating taxpayers, reducing compliance costs by getting things right from the start with enforcement remaining as a backstop for those who wilfully or intentionally disregard the law.

Fund specific comments:

- Fund-specific setting – exemption: Ideally the Fund should be tax exempt in line with best practice tax treatment for sovereign wealth funds (**SWFs**) around the world (we are the only SWF that is not exempt from tax in its home jurisdiction). It would increase efficiency by saving costs both:
 - Locally:
 - there would be no need to liquidate assets to pay tax;
 - there would be no need for the Fund to pay the Government provisional tax with the Government then turning around to pay the Fund contributions; and
 - it would result in lower contributions being made by the Government over time; and
 - Internationally:
 - the Fund would not have to work so hard to prove its entitlement to offshore SWF exemptions; and
 - it would bolster current foreign withholding tax exemptions given by certain foreign governments and potentially open up others.
- Settings for the Fund management industry: In relation to the fund management industry we consider the current settings i.e. the Portfolio Investment Entity Regime (PIE) (in respect of Australasian equities), the Fair Dividend Rate Regime (FDR) (in respect of non-Australasian equities) and the financial arrangement rules (in respect of bonds, deposits and derivatives) work well and should remain subject to the following:
 - Simplifying the current FDR and PIE foreign exchange hedging regime to remove complexity therefore enabling the industry to use it. A solution has been agreed in principle with Officials.
 - Revisiting the current FDR setting of 5 percent which, as noted in the Paper², overtaxes foreign equities.
- Industry specific tax regimes: New Zealand's current tax system was (in the main) developed deliberately and not as a matter of ad hoc reform. There are perfectly valid reasons (such as links to wider government policy) for a number of the regimes in place that would at first glance appear to sit outside of the BBLR tax framework eg:
 - the forestry regime (which recognises the long-term nature of the crop). This regime will be important given the current Government's policy to plant 100 million trees per annum over the next 10 years; and

² Refer to page 39 of the Paper.

- the taxation of the retirement industry which is a rapidly growing sector having to meet huge anticipated demand caused by demographic changes.

There should be a “high hurdle” before seeking to make any changes to industry specific tax regimes. Any adverse tax changes would have a direct effect on future investments and current asset values. Any proposed changes should be thoroughly considered via the GTPP.

- Provisional tax improvements for large taxpayers: The current settings for provisional tax payments do not work well for large taxpayers with volatile income streams (e.g. the Fund, some of the fund management industry and large exporters) and generally result in considerable overpayment of tax, high compliance costs and unwelcome high rates of use of money interest. Officials and the corporate sector have worked on an extension of the current Accounting Income Method known as the Tax Income Method (TIM) which would allow large corporates to pay their provisional tax during the income year based upon their detailed year-to-date tax calculations. Inland Revenue could consider introducing an accreditation regime similar to the one administered by the Reserve Bank of New Zealand for assessing capital adequacy. Once accredited, participants are able to use their own in-house models. We recommend that the TIM or the Fund specific provisional tax solutions discussed in our detailed submission should be implemented.
- Co-operative compliance agreement (CCA): The Fund’s enhanced relationship with Inland Revenue via a CCA works well with real-time engagement and a pre-filing tax return review by Inland Revenue. This reduces compliance costs for both the Fund and Inland Revenue and provides increased certainty for both parties. We support the continued availability of CCAs for the Fund and other large taxpayers as required.
- Offset of provisional tax against contributions: It would reduce transaction costs for both the Fund (in respect of realising investments) and the Government if the Fund was able to offset the Fund’s provisional tax due to the Government against the Government contributions to the Fund. We have discussed this concept with the Treasury previously and would welcome the Working Group’s support for this measure.
- Investors with differing tax profiles: There are varying tax profiles amongst taxpayers (eg the Fund, non-resident investors, charities, Māori Authorities etc) which impacts on their choice of investment vehicle. Investors with a non-standard tax profile will seek to co-invest in a way which allows income to be taxed at the investor level. The Fund believes that investment alongside other types of investors, and in particular the Māori economy, would be enhanced and simplified if a corporate flow-through vehicle such as a widely-held look-through company was available.

Tax profile of the Fund

The NZ Government’s income arising from the New Zealand Superannuation Fund is subject to New Zealand taxation based upon the company tax rules.

The Guardians, the Crown entity that manages and administers the Fund, is exempt from income tax. The Guardians breaks even for financial accounting purposes with its net expenditure being reimbursed by the Fund.

The Fund stands alone amongst its SWF peers in being taxed domestically.

Some of the rules applying to PIEs are available to the Fund, for example a realised gain tax exemption for New Zealand equities and certain Australian equities. As a result these investments are taxed on actual distributions received.

The FDR regime is applied to the majority of the Fund's foreign investments in shares/equities. This provides us with an exemption on realised and unrealised gains and losses and actual distributions. Instead we are taxed on a deemed distribution calculated at the rate of 5% of market value.

The Fund's tax position can be volatile depending on the performance of the fund and the contributors to that performance. This is often illustrated via our effective tax rate³³. For example, our effective tax rate was 3% in 2015, 96% in 2016 and 20% in 2017. The main driver of this volatility is how our physical global equities are taxed under the FDR regime. In simple terms, this means that in any given year if our return on global equities exceeds 5%, then our tax rate will be lower than 28%, and if our returns are less than 5% then our tax rate will be higher than 28%.

Weighing up tax policy proposals

It is difficult to comment meaningfully on proposals for change at this stage without knowing a) what potential policy changes might be offered up by other submitters, b) how any such change might be integrated into the current tax system and c) what the expenditure needs are to run the country and fund the transfer system. Context and design is important as is the trade-off of tax cuts that would need to be made elsewhere in the event that a new tax was introduced that materially expanded the tax base.

Thank you for the opportunity to submit a response to your consultation. Please advise if the TWG requires any further information or clarification in relation to our submission. We also welcome the opportunity to provide further comments following the publication of the interim report in September and before the final report is issued.

Yours sincerely



Matt Whineray
Acting Chief Executive Officer



John Payne
Head of Tax

³³ As the corporate tax rate is 28% you would generally expect an entity's effective tax rate to be somewhere in the vicinity of 28% (give or take percentage points either way).

APPENDIX I RESPONSE TO SPECIFIC QUERIES RAISED BY THE WORKING GROUP

[Note: The responses below are numbered so as to align with the Paper]

3. Purposes and principles of a good tax system

What principles would you use to assess the performance of the tax system?

In terms of assessing the performance of the tax system, we acknowledge and agree with the three main principles espoused by the CTG which is that a good tax system should be built around:

- High certainty, predictability and low business risk;
- Low compliance costs; and
- International competitiveness.

These principles have a particular corporate focus but significantly overlap with the orthodox principles for considering the cost/benefit of tax reform as described in the Paper ie: efficiency, equity and fairness, revenue integrity, fiscal adequacy, compliance and administration costs and coherence.

The Fund supports tax policy reform being analysed in terms of the '*Living Standards Framework*'⁴ developed by Treasury. It accords with the Fund's Responsible Investment framework and focus on Environmental, Social and Governance (ESG) matters. In our view, the Living Standards Framework should drive an appropriate focus on intergenerational equity/wellbeing.

However, even when applying all of these worthy principles there will often be situations where trade-offs are required. In that case, tax reform should be considered at the macro level so that it appropriately incorporates wider Government objectives and takes account of what is in the overall national interest.

How would you define 'fairness' in the context of the tax system? What would a fair tax system look like?

'Fairness' when applied to tax is a subjective and nebulous concept. Some commentators (aided by certain media) are prone to alleging something which does not suit them (whether in absolute terms or by comparison to others) is unfair. Often this arises on the basis of misinformation because tax is complex and the rules around taxpayer confidentiality often mean that, with the exception of Inland Revenue and the taxpayer, other people are not in possession of all the facts. Consequently it would seem difficult to reach popular agreement on what constitutes a fair tax system.

⁴ Refer to the Paper, Chapter 3, page 17. The four capitals are: financial & physical capital, human capital, social capital and natural capital.

However, there are steps which can be taken to address the perception of fairness in the tax system and that is by:

- educating the general public about the role the tax system already plays in contributing to the overall well-being of New Zealand;
- changing the narrative/values so that the general public is supportive of the reasons for paying tax; and
- ensuring any proposed policy changes are fully consulted on via the GTPP with due time given to consider the issues.

In the mind of most people, the concept of fairness will extend beyond the tax system to encompass the transfer system. Provided the New Zealand tax base settings collect the optimal amount of revenue, then it is up to the transfer system to ensure that the allocated portion of the revenue is distributed appropriately to those who need it. This dual focus increases the difficulty in demonstrating that one, amongst a number of interconnected systems, is fair.

4. The current New Zealand tax system

New Zealand's 'broad-based, low-rate' system, with few exemptions for GST and income tax, has been in place for over thirty years. Looking to the future, is it still the best approach for New Zealand? If not, what approach should replace it?

The tax system needs to be agile and efficient in delivering the revenue necessary to meet Government expenditure at the lowest overall cost to the New Zealand economy.

New Zealand's current system is based upon the BBLR tax framework which is centred around GST, personal income tax and company income tax. The BBLR tax framework has served New Zealand well and is currently delivering against the Government's required revenue needs. We would endorse continuing with the BBLR tax framework.

However, there are a number of observations we would like to make in relation to the current tax system and specific areas where it can be improved to reduce its overall cost to the New Zealand economy:

- The longstanding GTPP⁵ (designed to encourage early consideration of key policy elements and trade-offs of proposals and to provide opportunities for substantial external contribution to policy formulation) is under pressure with some recent reforms appearing rushed and contrary to New Zealand's overall national interest. We encourage a review and refresh of the current process to establish a framework whereby all the Government's policies can be taken into account on an holistic basis when determining whether or not a tax change is in New Zealand's overall long term interest rather than being driven primarily by short term revenue gain that appears overly influenced by Inland Revenue Officials base maintenance concerns.

⁵ The GTPP is an approach to developing tax policy used since 1995 that aims to ensure effective tax policy development through early consideration of key policy elements as well as revenue impact, compliance and administrative costs and economic and social objectives. Consultation and feedback are integral parts of the process. For more detail > <http://taxpolicy.ird.govt.nz/how-we-develop-tax-policy>.

- There needs to be a “high hurdle” to introduce new taxes outside the current very efficient and effective big three i.e. GST, personal income tax and company income tax. If the Government requires extra revenue then it should be gathered via these taxes which need to be agile enough to cope with changes in technology, the way people work and, in relation to company tax, needs to be responsive to changes made by other countries that compete with New Zealand in export markets and in attracting foreign capital.
- New Zealand’s current tax system has not developed by way of accident nor been primarily driven by ad hoc reform. Certain regimes that may at first instance appear concessionary and outside the BBLR framework were implemented for sound and considered reasons. For example:
 - the forestry tax regime (which allows for the immediate deductibility of planting and tendering costs) recognises the long term nature of the crop (30+ years from planting to harvesting); and
 - the retirement sector treatment of unrealised property revaluations and resident advances used for funding developments not being subject to tax as the properties are held for long term rental and resident advances are repayable (the sector is growing rapidly in order to meet the huge anticipated demand with demographic changes to New Zealand’s population).

There should be a “high hurdle” before seeking to make any changes to industry specific tax regimes. Any adverse tax changes would have a direct effect on future investments and current asset values. Any proposed changes should be thoroughly considered via the GTPP.

5. The results of the current tax system

Does the tax system strike the right balance between supporting the productive economy and the speculative economy? If it does not, what would need to change to achieve a better balance?

It is worthwhile acknowledging that there has been a significant amount of new legislation introduced in the last several years to curb perceived excesses around multinationals, corporates and property speculation. It will take time for the effect of those changes to filter through to become empirical data. We do not yet have the data to assess the impact of all of these policy changes which makes it difficult to ascertain whether the tax system has struck the right balance.

Does the tax system do enough to minimise costs on business?

The following are our suggestions for the Working Group – some points are in support of keeping the settings as they currently are. The remainder are suggestions for improvement. We are happy to supply any further clarifications as required.

What works well for the Fund

Co-operative Compliance Agreement

The Fund has a CCA with Inland Revenue which in our view is extremely beneficial in managing our tax position and obligations. The CCA allows for real time engagement between the Fund and Inland Revenue and a pre-filing review of our income tax return. In practice, the combination of the CCA and real-time engagement allows us to explore more pragmatic solutions (because we are discussing the options for the tax treatment with Inland Revenue in advance of filing) and to achieve practical certainty. From Inland Revenue's perspective it provides full transparency and a better understanding of our tax position.

The international tax rules that apply to our investments in foreign investment funds (FIFs) and controlled foreign companies (CFCs) can be exceedingly complex. Real time engagement with the Inland Revenue regarding these complexities can assist with reducing compliance costs.

Fund industry tax settings

- FDR

The vast majority of our investments in FIFs (i.e. foreign shares) are subject to FDR. In general terms this is a simple and low compliance cost regime. At times it creates strange results for our effective tax rate which requires on-going communication with our stakeholders but it generally works well. We have noted below some refinements which would improve the application of the FDR rules (rate reduction and functioning of FDR and FX hedging regime).

- PIE Exemption for Australasian Shares

The Fund's Australasian investments in shares generally qualify for the PIE exemption for realised gains. As a result these investments are only taxed on actual distributions received. This regime is simple and results in low compliance costs so is beneficial to the Fund.

- IFRS taxpayer method for financial arrangements

The fund has a significant number of financial arrangements with varying levels of complexity. We generally use the IFRS taxpayer method which allows the accounting treatment to be followed for tax purposes (with a few exceptions). This is a great result and saves us a huge amount in compliance costs and complexity in our tax calculation (the Fund currently has around 25,000 financial arrangements and this will only increase especially now that contributions have restarted).

Suggestions for improvement

Fund-specific setting – exemption

Ideally the Fund should be tax exempt in line with best practice tax treatment for SWFs around the world (we are the only SWF that is not exempt from tax in its home jurisdiction). It would increase efficiency by saving costs:

- locally because:
 - there would be no need for the Fund to liquidate assets to pay tax;
 - there would be no need for the Fund to pay the Government provisional tax with the Government then turning around to pay the Fund contributions, thereby removing the need for practical work arounds in terms of offsetting provisional tax and contributions; and
 - it would result in lower contributions being made by the Government over time in terms of the funding formula in the *New Zealand Superannuation and Retirement income Act 2001*; and
- Internationally because:
 - the Fund would not have to work so hard to prove its entitlement to offshore SWF exemptions (a number of international tax laws provide automatic exemptions to SWFs if they have an exemption in their home country); and
 - It would bolster current foreign withholding tax exemptions given by certain foreign governments and potentially open up others ie if it is good enough for New Zealand to tax the fund and in effect 'claw back' tax exemptions given by other jurisdictions, the other jurisdictions are incentivised to tax the income themselves as New Zealand will give a credit for any foreign tax paid.

Fund Industry Tax Settings

In relation to the fund management industry we consider the current settings noted above (FDR, PIE exemption for Australian shares and IFRS taxpayer method for financial arrangements) work well and should remain subject to the following points:

- *FDR Rate Reduction*

We agree with the Working Group's proposition⁶ that the current FDR rate of 5% is too high. We would recommend a review of the level of the rate with the view to reducing it.

- *FDR and FX hedging regime*

We have been in ongoing discussions with Inland Revenue's Policy and Strategy group and Treasury regarding the application of the FDR and FX hedging rules. These rules were intended to align the taxation of FDR and Australasian equity investments subject to the PIE exemption (which are subject to tax on a 5% deemed dividend or actual dividends received respectively) with the hedging of these investments (with gains being fully taxable and losses fully deductible).

These rules are a good example of a regime that was supported by industry but has been poorly implemented via overly prescriptive rules. As a result, the Fund has been unable to apply the rules which would be very beneficial in terms of reducing the volatility in our effective tax rate.

⁶ Refer to page 39 of the Paper.

We have proposed a legislative change to allow us (and other taxpayers) to implement the rules which would involve including a determination making power. We hope that this change makes the tax policy work programme in the near future. We are happy to provide further details in respect of this if required.

Provisional Tax

The provisional tax system is unfavourable for an investment fund such as the Fund with volatile earnings. The Fund's taxable income is extremely volatile and can change markedly both during an income year and from income year to income year. The recent changes to the uplift method are useful but do not go far enough – an uplift method is not palatable following a record year in terms of our taxable income - unless subsequent earnings happen to be in line with that. For example, the Fund's residual income tax for 2017 (upon which future provisional tax calculations are based) was \$1.1bn. It seems inequitable to be required to pay provisional tax based on an uplift of a previous (record) taxable income when our year-to-date calculations indicate that the tax payable in a future year is likely to be much lower. It is particularly disadvantageous where the Fund is required to liquidate assets to pay provisional tax.

Where paying provisional tax based on the uplift method is not commercially feasible, we are forced into the estimation method which requires a forecast of future earnings which also exposes us to use of money interest if we get that forecast wrong. For the Fund, achieving an accurate forecast of taxable income would involve predicting foreign exchange and equity markets, which is impossible.

We support the introduction of an equivalent to the accounting income method (AIM) for large corporates. A pay-as-you-go method based on actual results to date is preferable to a method that involves using large uplifts or estimation of volatile earnings.

It could be worthwhile studying the accreditation approaches taken by other New Zealand regulators such as the Reserve Bank of New Zealand (RBNZ). The RBNZ operates the standardised approach regime for assessing compliance with the capital adequacy framework. Potential participants go through a rigorous accreditation process and, once accredited, they are able to use their own in-house models. The Fund has systems and processes in place to provide Inland Revenue with the necessary comfort that such a regime would be used appropriately. The Fund also has a high level of engagement with Inland Revenue.

Alternatively, a quarterly calculation option such as currently available for PIEs could also be a useful option for the Fund.

A firm commitment to reducing complexity and compliance costs

New Zealand tax legislation has become more and more complex for various reasons including the changing business environment, heightened concerns by Revenue Officials in respect of the integrity of the tax base, the apparent need for Officials to achieve absolute precision and a reluctance to use existing legislative tools (such as the land taxing rules which have been place for decades and the general anti-avoidance provision). This increased complexity has resulted in the need for continual remedial legislation to cope with unintended consequences or overreach.

To reduce this complexity, increase certainty in a timely manner and to reduce compliance costs we submit that Inland Revenue should form a dedicated unit within Tax Policy and Strategy to deal solely with remedial legislation. In addition, we submit that the Commissioner should have the ability to issue determinations and/or regulations (subject to checks and balances) on what is acceptable i.e. in line with policy intent. An example of where this could be useful is as we have proposed above in respect of the FDR and FX hedging rules. This combination of measures, along with a change of mindset from Revenue Officials would improve the health and integrity of the tax system.

(Note there has been some discussion about providing the Commissioner with a power to make regulations as part of Inland Revenue's Business Transformation (BT) project. The Terms of Reference specify that the Working Group should not focus on matters that are already under review including policy changes as part of BT. However, in our view the ability to solve for unintended legislative consequences extends beyond the administrative changes which are the focus of BT. Further, it is not always apparent whether something will end up being progressed as a policy change once a review exercise has been concluded and hence we have included this important item our submission).

Are there types of businesses benefiting from low effective tax rates because of excessive deductions, timing of deductions or non-taxation of certain types of income?

Refer to our comments made earlier under #4 'The Current Tax System'.

6. Thinking outside the current system

What are the main inconsistencies in the current tax system? Which of these inconsistencies are most important to address?

- It would reduce transaction costs for both the Fund (in respect of being required to realise investments) and the Government if the Fund was able to offset the Fund's provisional tax due to the Government against the Government contributions to the Fund. We have discussed this concept with the Treasury previously and would welcome the Working Group's support for this measure.
- We understand that Inland Revenue has traditionally been measured based almost entirely on tax adjustments made following audit activity therefore driving a certain type of behaviour in terms of the pursuit of tax adjustments. We submit that key deliverables for Inland Revenue should be reset to focus primarily on providing certainty for taxpayers, reducing compliance costs (for both taxpayers and the Government) therefore giving businesses more time and resource to focus on running their businesses, getting things right from the start and educating taxpayers as to why it is important to pay tax to fund Government services. Clearly enforcement will remain for those taxpayers who intentionally disregard the tax law so as to protect the integrity of the tax system and to encourage voluntary compliance.

- Most investors prefer to use the traditional corporate model because a company is familiar and fairly simple to use. However, a company does not accommodate varying tax profiles well (eg the Fund, non-resident investors, charities, Māori Authorities etc). Using a company can result in over-taxation relative to the tax profile of the investor. As a result investment structures can become complex where investors with differing tax profiles seek to co-invest in a way which allows income to be taxed at the investor level. The Fund believes that investment alongside other types of investors, and in particular the Māori economy⁷, would be enhanced and simplified if a corporate flow-through vehicle such as a widely-held look-through company was available.

*Is there a case to consider the introduction of any new taxes that are not currently levied?
Should any taxes be reduced if new taxes are introduced?*

We do not make comment on whether there should be new taxes introduced. However, in the event that the Government was to introduce new taxes that are not currently levied, we believe that there should be a rebalancing exercise undertaken to reduce taxes elsewhere (whether fully compensatory or partially so).

⁷ By way of additional background, see announcement: [First steps taken towards Māori Co-Investment Fund](#) regarding a partnership project entered into between the Fund and Ngāti Awa Group Holdings Limited.

APPENDIX II THE FUND'S ROLE IN CONTRIBUTING TO NEW ZEALAND'S SAVINGS AND FUTURE WELL BEING

1. Introduction

The [New Zealand Superannuation Fund](#) invests money, on behalf of the Government, to help pay for the increased cost of universal superannuation entitlements (New Zealand Superannuation) in the future.

By doing this the Fund adds to Crown wealth, improves the ability of future Governments to pay for superannuation, and ultimately reduces the tax burden of the cost of superannuation on future New Zealanders.

The Fund is managed by a Crown entity, the Guardians.

Since 2003, the Government has contributed \$15.1 billion to the Fund which, as at 28 February 2018, was worth \$38.4 billion. The Guardians have successfully invested the Government's contributions in New Zealand and overseas, returning 10.45% per annum, after costs and before tax, since the inception of the Fund. This rate of return is around 6.34% per annum higher than the rate of return on Government debt.

Since inception, the Fund has paid \$6.25 billion in tax to the New Zealand Government. The Guardians include New Zealand tax paid in measurements of the Fund's performance because we consider it to be a return to the Crown.

2. Why the Fund exists

New Zealand Superannuation is the retirement benefit currently paid to all eligible New Zealanders aged 65 or over.

New Zealand Superannuation is currently funded on a "Pay As You Go" (PAYGO) basis. This means that the cost of New Zealand Superannuation in any one year is currently paid from the taxes New Zealand workers and businesses pay in that same year.

Over the next few decades, the New Zealand population will age significantly. Statistics New Zealand predicts that the population aged 65 years and over will surpass one million by the late 2020s, compared with 550,000 in 2009. The 65+ age group will also grow as a proportion of New Zealand's total population, increasing from 13% in 2009 to more than 20% by the late 2020s. By the late 2050s, one in every four New Zealanders will be 65 years or older.

As New Zealand's population gets older, the cost of New Zealand Superannuation is going to increase. The Fund was therefore established as a "Save As You Go" (SAYGO) mechanism that will help prepare for this increase and smooth the cost of New Zealand Superannuation between today's taxpayers and future generations.

The Fund will not alter the future cost of New Zealand Superannuation, but it will improve its affordability through accumulated savings and investment returns in excess of alternative funding methods. In particular, both to date and going forward, we expect the returns from our investing activities to well exceed the nominal GDP growth rate of the NZ economy, which is the

“return” under a PAYGO system, given tax revenues approximately grow with the rate of nominal GDP growth (absent any changes in tax rates themselves).

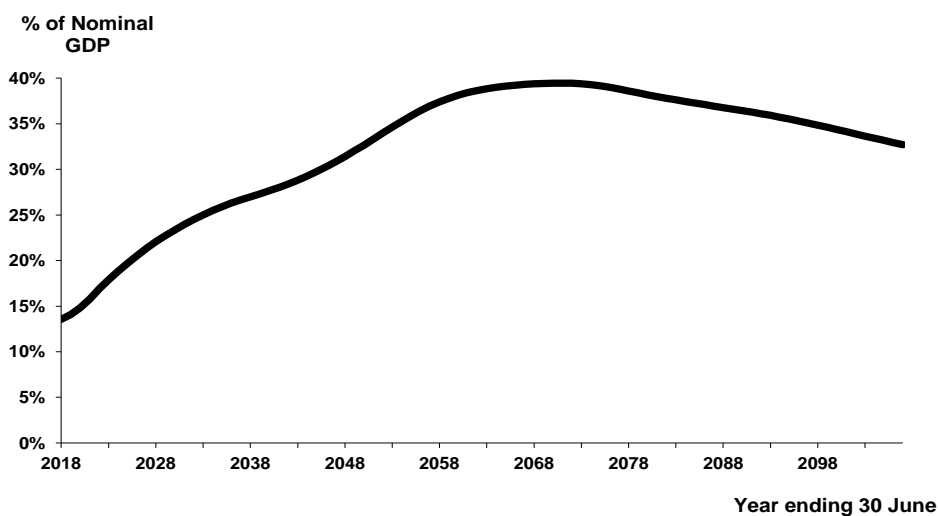
In addition to improving affordability of New Zealand Superannuation, the Fund reduces the risks around its funding because its investment returns are a function of global economic conditions and asset markets, rather than New Zealand conditions alone, as is the case with a pure PAYGO system.

3. A long-term investor

The Government will begin to withdraw money from the Fund to help pay for New Zealand Superannuation around 2035/36. The Fund will continue to grow until it peaks in size in the 2070s.

This long timeframe is reflected in the Fund’s Mission Statement: “Maximise the Fund’s returns over the long term, without undue risk, so as to reduce future New Zealanders’ tax burden.”

Projected size of the New Zealand Superannuation Fund over time



4. Environmental, Social and Governance

One of the Fund’s beliefs is that environmental, social and governance factors (**ESG**) impact investment performance over the long-term. ESG considerations are therefore integrated into all aspects of the Fund’s investment activities, from investment selection and due diligence to ownership activities such as monitoring our external investment managers, exercising our voting rights and engaging with companies to improve their ESG policies and practices. The Fund has a Responsible Investment team dedicated to managing ESG issues.