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Gareth Morgan: Investment still biased towards property

By Gareth Morgan
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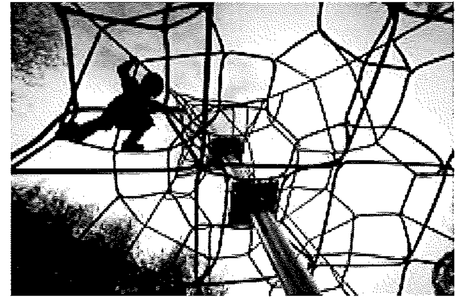
Investors face a tangle of choices because of the tax regime. Photo / Mark Mitchell

The Budget's rise in GST in theory encourages savings, a not altogether futile objective in a country that supports its lifestyle by borrowing from savers in the rest of the world.

But typical of that document, the changes to our tax regime will be remembered more for their unintended than their intended consequences.

In short the concept of tax neutrality seems to have escaped the Government and its tax policy advisers.

While the decision to remove the depreciation tax allowance on an asset (property) that shows little long-term depreciation beyond that offset by tax deductible repairs and maintenance spending, gets rid of a double dip tax benefit for property investors, it will take a lot more from the Government to negate the powerful bias towards property.

Indeed overall the Budget has encouraged it.

The current tax regime on saving in other forms of investment remains a total dog's breakfast thanks to the maintenance of this silly portfolio investment entity (PIE) regime and the reduction in its top rate to 28 per cent - miles below the top personal rate of 33 per cent.

It maintains a tax advantage for higher income savers using certain types of institutionalised grouped investments. But widening this bias will, I suspect, have an important unintended consequence.

You might expect the cut in the tax rate to 28 per cent on grouped investments would result in investors abandoning self-management of their saving in favour of handing their savings over to financial institutions.

But handing control to faceless institutions, some of which have an appalling track record of destruction of long-term savings and which operate in a regulatory environment where very few miscreants ever face any legal consequences of their actions, is hardly going to be an attractive option for savers, despite the Government's manipulation of the tax rate to persuade them.

Institutional management of people's long-term savings has a distinguished track record of wealth annihilation, and this legacy is going to be hard to shake off.

In the absence of large government subsidies, grouped investments such as KiwiSaver, superannuation and unit trusts have severely limited appeal to investors.

The investor loses all discretion as to how they invest and manage their savings, and they cannot easily rescue their money until the damage is done.

Not only are they dubious avenues for individuals to channel their wealth into but from a national perspective they are a weak link also.

To suggest that the funds management industry is a better investor of our savings than we would be ourselves is to draw a very long bow. Certainly foreign outfits such as ANZ and ING have a lot to prove in this regard.

Indeed when you combine the tax-induced grouping of savings under the PIE regime with the obscene accumulation of tax money within the Cullen Fund, we are steadily marching towards a scenario where the vast bulk of non-property assets will be controlled by very few managers.

No wonder the NZX's future looks bleak - its private sector customer base is steadily being diverted to direct property investment instead.

Between them, Australian banks and fund managers and government servants running the Cullen Fund control increasing tracts of private capital.

There's no need for an NZX when you no longer have mums and dads in control of their own investments.

The PIE regime is an aberration, instigated at the behest of the funds management industry to give those intermediaries a competitive advantage over individuals who wish to control the management of their own savings.

Operating the Fair Dividend Rate tax regime alongside the classic capital and income account tax regime has given rise to unbelievable complexity in the tax rules, and therefore expense, for investors.

And we are left more than ever with the tax regime and its application to investment, giving investors little choice but to either surrender sovereignty over their savings to some faceless institution, or to opt out of the wider investment market and just buy property.

At least direct ownership of property keeps their tax affairs simple, enables them to keep management control of their savings, and if they form a company to do it, enables them to exploit the lowest tax rate.

If you combine that with the Reserve Bank's ongoing preference for banks to lend on mortgage and the fact that capital gains aren't taxed at all, it's a no-brainer.

The increasing vulnerability of government policy to lobbying and threats from multinational financial institutions and their footsoldiers within corporate legal and accounting firms is steadily reducing the real choices people have to save and invest their money where they choose.

That is bad for our economic future, reduces the economy's ability to withstand shocks, sponsors an ongoing misallocation of capital, and will make even more retirees dependent solely on the state pension.

It is hard to believe that a Government that declared it wanted to promote investment literacy and address inequities in the tax regime could be such a slave to the interests of the big end of town.

*** Dr Gareth Morgan is a director of Gareth Morgan Investments and was a member of the Tax Working Group.**

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