

Strengthening Economic Relations Between Australia and New Zealand

Overview

This submission has the key focus on just one question from the 'Issues paper' and that is:

Q.29

What other policy-related barriers are there to trans-Tasman capital flows? What should be done about them?

The focus of this submission are the barriers that deter investment by New Zealand resident taxpayers in company shares listed on the Australian Stock Exchange (ASX).

The three main barriers include the following:

- The general lack of financial literacy surrounding the investment in company shares.
 - Constraints imposed by banks in the purchase and deposit of Australian funds.
 - Compliance with the Foreign Investment Fund (FIF) tax regime administered by Inland Revenue.
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Recommendations

1. That education programmes, including increased funding, to lift New Zealander's financial literacy especially with regard to investing in company shares should be a matter of priority.
 2. That trading banks should be encouraged to reduce the delays, and costs, in the processing of Australian funds especially those coming into New Zealand in the form of company dividends.
 3. That the New Zealand law / rules/ regulations, especially those of the FIF tax regime, relating to investments made by New Zealand resident tax payers in ASX listed companies should be urgently reviewed with the object of significant liberalisation if not abandonment.
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The Attraction Of Australian Shares

The attraction of the Australian share market to investors such as myself probably includes some or all of the following factors.

- Greater variety and scope
 - Family & Friends
 - New Zealand opportunities declining
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Greater Variety and Scope

The Australian Stock Exchange (ASX) offers opportunity to New Zealanders to invest in, for example, a wide range of specialist companies as well as mining and resource exploration & development companies. Ten examples are listed below:

Global Construction	Scaffolding
Greencross	Veterinary services
1300 Smiles	Dental practices
IMF Australia (*)	Legal & litigation funders
Infigen Energy	Wind & solar power generation
Industrial Minerals	Mineral sands
Venture Minerals	Tin & tungsten
Lynas Corp (*)	Rare earths
Altura Mining	Coal, Iron & Lithium
Cobar Consolidated	Silver

(*) Of the above only two, IMF Australia and Lynas Corp are FIF exempt.

Family, Friends, Business and Holiday

With so many New Zealanders now living and working in Australia there appears to be a desire to invest in businesses that Australian domiciled family & friends are involved in.

Australia is easily the most common destination, accounting for almost half of all overseas trips by New Zealand residents. Nearly a million New Zealand residents visit Australia each year. The next most popular three, USA, UK and Fiji, account for about 300,000 in total or less than a third that of Australia.

Clearly Australia is attractive to New Zealanders, it is familiar territory and despite mining taxes, etc it poses little sovereign risk to New Zealanders. Investing in their enterprises is a logical extension.

New Zealand Opportunities Declining

Three years ago, 30th June 2009, the NZ stock exchange (NZX) hosted 233 listings with a market capitalisation of \$49 billion. Today, (19 April 2012), there were just 166 with a market capitalisation of \$58.4 billion.

In January 2012 the ASX by way of comparison had 2,221 listings with a market capitalisation of \$A1.2 trillion.

At least one, (there may well be others), New Zealand based and operating company has decided to ignore listing on the NZX preferring the ASX. e.g. Neuren Pharmaceuticals. So if a New Zealand resident wants to invest in this local company they have to do it through the ASX.

Recommendation 1

That education programmes, including increased funding, to lift New Zealander's financial literacy especially with regard to investing in company shares should be a matter of priority.

"The worldwide economic downturn and finance company collapses in New Zealand have highlighted the importance of financial literacy. It's high on the agenda in New Zealand and internationally. Around the world, the impact of the crisis on ordinary people has created what we call a 'teachable moment' for financial literacy – people are more aware that they need to manage their money well, but unfortunately their knowledge of how to do it is patchy".

[Sean Carroll, Chair of the National Strategy for Financial Literacy Advisory Group in the 'National Strategy For Financial Literacy'].

New Zealand's National Strategy for Financial Literacy was launched in June 2008. Since then the economic climate has continued to highlight the importance of financial education.

Each day New Zealand's metropolitan newspapers publish tables of share prices, sales and other data for both New Zealand and a selection of Australian stocks. To many New Zealanders this information is unfortunately a load of gibberish and any moves to remedy this ought to be encouraged.

Australian friends in recent discussions spoke enthusiastically about Self Managed Super Funds. (SMSF). They called them their DIY super fund and particularly enjoyed the level of control and flexibility that couldn't be matched by traditional superannuation alternatives. One of the major benefits was that they became a lot more interested in company shares and wanted to learn more about investing in them. This I understand has had the consequence of an increased level of related education programmes.

For nearly two decades Self Managed Super Funds (SMSF's) have been the fastest growing sector of superannuation in Australia. The number of self managed funds in operation has grown from less than 100,000 in 1994 to more than 456,000 at June 2011 with nearly 900,000 members.

At least one New Zealand Kiwi Saver fund, (Craigs), operates a 'Self Select' style for retirement savings. This is a long way short of the Australian SMSF opportunity but is a welcome step.

Recommendation 2

That trading banks should be encouraged to reduce the delays, and costs, in the processing of Australian funds especially those coming into New Zealand in the form of company dividends.

Having to wait 21 working days for a dividend cheque from an Australian company deposited into a New Zealand bank to clear is very strange in this age of 'speed of light' electronic communications. It is particularly galling when the issuing bank is the parent company of the NZ bank into which the cheque is being deposited. In addition to this time impost the fees and usurious exchange rate attached to this transaction are eye watering.

Purchasing an Australian draft to pay for a capital raising attracts not just a higher exchange rate but a fee, typically \$NZ22, for the privilege.

Among the consequences of this sad state of affairs is that New Zealanders are opening bank accounts in Australia when on holiday. This is so that dividends can be paid directly into such an account, earn interest and be available for the next Australian holiday or for the next capital raising.

Another consequence is that Australian companies that offer dividend reinvestment plans are viewed more favourably than those that do not offer such a plan. Better still are those companies that offer shares at a discount bought via the dividend reinvestment plan.

Recommendation 3

That the New Zealand law / rules/ regulations, especially those of the FIF tax regime, relating to investments made by New Zealand resident tax payers in ASX listed companies should be urgently reviewed with the object of significant liberalisation if not abandonment.

Specifically, I submit that:

3.1 That the New Zealand law / rules/ regulations with regard to the FIF tax regime be amended so that all investments by New Zealand resident tax payers in ASX listed companies be repealed.

Australia has abandoned their FIF tax regime largely on the grounds of trying to provide for an internationally competitive tax regime for Australian investors looking to expand offshore. We should do likewise.

The New Zealand FIF tax regime appears to have been designed to discourage New Zealanders from investing their cash overseas and to put it instead into local finance companies and the housing market. It appears to have worked.

The complexity of the FIF regime might perhaps be great at providing work for tax advisors and as such it does little to address compliance costs for Mum & Dad investors or to help remedy New Zealand's poor savings record.

The FIF regime also demonstrates a two-faced attitude towards capital gains taxes.

In the event that the above submission falls on stony ground I submit that:

3.2 As an initial first step the number of ASX listed companies qualifying to be FIF exempt could be the 1,000 companies that have the highest market capitalisation as at 31st December each year

The number of ASX listed companies, (approximately 465), that are currently listed by Inland Revenue as being exempt from the FIF tax regime, (Refer: IR 871), is woefully inadequate. The figure of 1,000 is arbitrary but perhaps a useful starting point. It is still less than half of the total number of ASX listed companies.

The compilation of the current exempt list is so complex that Inland Revenue has contracted out of this task. By adopting a simple measure such as market capitalisation the job becomes so much easier.

The complexity and rules surrounding the compilation of the exempt list has resulted in numerous anomalies. Looking at the table below examples can be easily found.

Company	Code	Activity	Market Cap \$A Million	Website	Yearly Turnover \$A Million	Pays Franked Div	Registered In Aust	Comment
ASX Listed Companies That Are NOT FIF Exempt (A sample of 10)								
Altura Mining	AJM	Coal Iron Lithium	76.5	www.alturamining.com	24.6	No	Y	
Cobar Consolidated	CCU	Silver	138.9	www.ccrlimited.com.au	119.8	No	Y	
Global Construction	GCS	Scaffolding	133.6	www.gcs-group.com.au	33.1	Y	Y	
Greencross Ltd	GXL	Veterinary	35.4	www.greencrossvet.com.au	7.3	Y	Y	
Hansen Technologies	HSN	IT	156.7	www.hsntech.com	47.9	Y	Y	
Industrial Minerals	IDM	Min Sands	89.1	www.industrialmineralscorp.com.au	13.4	No	Y	Operates in USA
Ludowici	LDW	Eng/Drill	106.4	www.ludowici.com.au	20.8	Y	Y	
Mastermyne Group	MYE	Mining Services	103.3	www.mastermyne.com.au	19.8	Y	Y	
Qube Logistics	QUB	Transport	1076.1	www.qubelogistics.com.au	433.6	Y	Y	Company says it is an ASX 200 company
Venture Minerals	VMS	Tin Tungsten	81.8	www.ventureminerals.com.au	108.6	No	Y	
ASX Listed Companies That Are FIF Exempt (A sample of 10)								
Berkeley Resources	BKY	Uranium	58.4	www.berkeleyresources.com.au	163.9	No	Y	Operates in Spain
Boom Logistics	BOL	Cranes	120.9	www.boomlogistics.com.au	50.0	No	Y	
Chalice Gold	CHN	Gold	72.5	www.chalicegold.com	46.0	No	Y	Operates in Eritrea
Coffey International	COF	Services	89.7	www.coffey.com	37.7	Y	Y	
K & S Corporation	KSC	Transport	107.2	www.ksaroup.com.au	9.9	Y	Y	
Melbourne IT Limited	MLB	IT	113.5	www.melbourneIT.com.au	44.6	Y	Y	
Nyota Minerals	NYO	Gold	64.5	www.nyotaminerals.com	7.7	No	Y	Operates in Ethiopia
Pluton Resources	PLV	Iron	59.0	www.plutonresources.com	146.2	No	Y	
AV Jennings	AVJ	Bldg	123.6	www.avjennings.com.au	4.7	Y	Y	
WDS Ltd	WDS	Engineering	95.5	www.wdslimited.com.au	37.6	Y	Y	

The above table was compiled in December 2011. There may have been some changes between then and now.

The complex mish mash of rules yields anomalies like the following:

- Melbourne IT (MLB) exempt when Hansen (HSN) is not?
- Coffey International (COF) exempt when Ludowici (LDW) is not?
- Boom Logistics (BOL) is exempt and Global Construction (GCS) is not?
- WDS Ltd (WDS) is exempt when Mastermyne (MYE) is not? And so on.

Looking now at the resource sector, we have for example the following four companies that are all FIF exempt:

Chalice Gold (CHN) *Nyota Minerals (NYO)*
Pluton Resources (PLV) *Berkeley Resources (BKY)*

The following four and arguably more meritorious are NOT FIF exempt:

Cobar Consolidated (CCU) *Industrial Minerals (IDM)*
Venture Minerals (VMS) *Altura Mining (AJM)*

Further more CCU and VMS have their mining operations in Australia and not Ethiopia, or Eritrea or Spain. None of the above eight companies pay a dividend but all are Australian registered

A quick count of the FIF regime exempt companies showed that approximately 170 – about 1/3rd - do not pay a dividend. So the issue of 'franking credits' does not arise. It will be of no surprise that many of these were junior resource explorers, developing biotech's, etc with years to go before they ever into a position to pay a dividend. That being so why are some exempt when others with apparently better credentials are not?

ASX Listed Companies That Are FIF Exempt (A sample of 3)

Company	Code	Activity	Market Cap \$A Million	Yearly Turnover \$A Million	Pays Franked Div	Registered In Aust
Bentley Capital	BEL	Invest	12.8	3.2	Y	Y
Peters MacGregor Invest	PET	Invest	17.6	1.8	Y	Y
WAM Active Ltd	WAA	Invest	16.8	3.5	Y	Y

In the table above the three companies identified are FIF exempt. Yet as can be seen in the first table Greencross (GXL), for example, is more than twice the size in terms of both market capitalisation and annual share trading turnover plus it actually does something useful. The anomaly is that Greencross (GXL) is not FIF exempt when the above three minnows are.

Changing to a much simpler determination, such as the 1000 highest ranked ASX listed companies based on market capitalisation abolishes these anomalies.

Listing the qualifying companies as at 31st December, effectively January, gives investors time to consider their positions and begin to make decisions for the upcoming tax year. Currently, Inland Revenue publishes their FIF exempt schedule, (IR871), several months after the income tax year has ended. This

practice imposes additional and unnecessary risk for investors in ASX listed companies. For example the current IR871 was not made available until May 2011 for the income tax year ending 31 March 2011. Investors who bought ASX listed shares during the year have had to sit and hope that their investment was one of the lucky ones that did not incur the wrath of the FIF regime. Investing in shares carries a degree of risk this does not need to be supplemented by our tax administration.

3.3 The current level of exemption, (de minimis), of \$50,000 be increased to \$250,000 with the view to increasing it substantially (say another \$250,000) each year.

In this day and age \$50,000 is a very low threshold and ought to be raised to something like \$250,000 or more. A person earning \$150,000 per annum and contributing 8% of their pre-tax income to savings will reach \$50,000 in about 4 years.

The FIF tax regime imposes unnecessarily high compliance costs for Mum & Dad investors. I would not be surprised if the quantum of tax raised from these small investors is insignificant. Contributing to the matter is the stunningly complex FIF return form (IR443) produced by Inland Revenue.

Increasing the number of exempt companies and raising the exemption threshold will no doubt be welcomed by many Mum & Dad investors who have an interest in ASX listed shares.

Ministerial Correspondence

Correspondence with the Minister of Revenue, Hon Peter Dunne, and his officials, in Nov – Dec 2011 with regard to the above matter was useful and informative but they do not have the authority to effect change.

Conclusion

Trans-Tasman capital flows will, in my opinion and perhaps somewhat naively, be enhanced by fixing a number of issues that are possibly at the micro end of the spectrum. The biggest issue, and probably the most difficult, is developing and implementing a strategy to lift financial literacy especially in regard to the buying and selling of equities. Australia is familiar territory for many New Zealanders so widening our investment choices, making it easy to do and removing the associated taxation impediments may well be a step in the right direction.