

GST on fund fees: What happened and where to from here?



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The proposal by the Government to charge GST on fund management fees received a lot of media coverage and ultimately forced a u-turn. So what happened?

Was it a simple tax grab as some commentators suggested? Or was it an attempt to correct an anomaly in the current GST rules, which have been lauded for their broad coverage and simplicity, by levelling the playing field as the Government claimed.

Before attempting to answer this, it is worth reflecting on the current GST landscape for managed funds.

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The Goods and Services Tax Act 1985 contains a definition of activities that are 'financial services'. That definition includes arranging the issue, purchase or sale of financial products, such as shares or bonds (i.e. 'arranging investments'). However, related activities, such as financial advice on investments, or certain administrative tasks, such as investor reporting, are not financial services. Therefore, these activities attract GST at the standard rate of 15%.

The rationale for this distinction is that GST is meant to be a tax on consumption of goods and services. It should not apply to the actual investment or savings activity, but should be imposed on services, such as financial advice, that help investors decide both how and where to invest.

This line can get blurred, particularly when investing in managed funds. This is because the fees that fund managers charge to investors in funds will be for a variety of services. These fees will include:

- issuing the investments in the fund to investors and managing the investments of the fund ('fund manager services');
- providing advice to the fund on investments or outsourcing this activity ('investment manager services'); and

- reporting to investors and regulators and other costs of running the fund ('administrative services').

Depending on the underlying service being provided, GST may or may not apply to the associated fee component. However, a single fee may be charged to investors, for simplicity, meaning that the GST treatment is not obvious.

Given the potential difficulties in untangling the different components, a variety of approaches have been historically adopted by different fund managers. This includes:

- Treating 90% of the fees relating to both fund manager and investment manager services as exempt from GST. This treatment is favoured by most large fund managers and was agreed with the Inland Revenue Department (IRD) under an industry agreement in the early 2000's. (In some cases, this treatment has also been applied to administrative services, which the IRD considers to be incorrect.)
- Applying GST on all fund fees (on the basis that the fees charged are principally for investment advice). This treatment is favoured by some smaller (or 'boutique') fund managers.

To complicate things further, the management of a retirement scheme is a financial service that is fully exempt from GST. This means that



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no GST applies to management fees charged to investors in KiwiSaver schemes. (However, if the KiwiSaver scheme invests in a non-KiwiSaver fund, for example, investors may indirectly incur GST on fees charged in the non-KiwiSaver fund.)

Given the range of GST treatments that currently apply in practice, the IRD has indicated its preference for a single, consistent treatment. Getting agreement on what that should be has been the thorny issue given the different (and sometimes entrenched) industry views.

As the [Regulatory Analysis](#) accompanying the former August Tax Bill (yes, the original Tax Bill was withdrawn and introduced without the GST change in September) notes, there are a myriad of different options, with pros and cons for each:

- **Option 1:** Legislating current industry practice – i.e. a full exemption for KiwiSaver scheme management fees and a 90% exemption or full GST treatment depending on the approach adopted for other funds.
- **Option 2:** Make fund manager and investment manager services fees subject to full GST.
- **Option 3:** Make fund manager and investment manager services fees fully GST exempt.
- **Option 4:** No legislative change and enforcing the IRD’s current view of the law – i.e. a full exemption for fund manager services and full GST on investment manager and administrative services²¹.

The IRD’s preferred approach, and the option that was included in the August Tax Bill, was to make all fund fees subject to full GST (Option 2). This was on the basis of providing a certain and consistent GST treatment and simplifying compliance.

The main disadvantage was the additional GST cost (estimated to raise \$225+ million a year) and who would bear this costs – investors or fund managers? The Regulatory Analysis indicated that at least some of the additional GST cost was likely to be passed on to investors by way of higher fees. Modelling by the Financial Markets Authority, included in the analysis, suggested that KiwiSaver balances

would be lower by \$103 billion by 2070 (compare to \$2.196 trillion of total KiwiSaver balances) and lower by \$83 billion (compare to \$1.757 trillion of total balances) for other funds as a result. The rest, as they say, is history.

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There was no doubt that the preferred option was going to raise additional revenue when KiwiSaver scheme fees were explicitly included within the scope. It was also likely that at least



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some (if not most) of the additional GST cost was likely to be passed on to investors. So, the reaction from the public and media was not surprising, particularly when there was no mention of the GST change in the press release accompanying the August Tax Bill, fuelling theories of a stealth tax increase.

But it is also correct that applying GST to fees across the board would have resulted in greater consistency. The alternative approach to get consistency, a full exemption, was not favoured by the IRD policy officials on the grounds that it would be less sustainable over time as it could create boundary issues in determining whether a service was a management service or another type of service (depending on how the relevant services are defined). That concern too has some merit.

Whichever argument you prefer will be ‘in the eye of the beholder’. What is clear, however, is that with the August Tax Bill re-introduced without the GST change for managed fund fees, we are now left in a state of limbo. It seems unlikely that this Government (or any future Government) will want to revisit this matter in a hurry. In which case, what happens now?

If, as we now expect, the status quo remains the question will be how (and if) the IRD will look to apply the current GST rules and the industry and public reaction to that. Get ready for round two.