Tax Working Group Public Submissions Information Release

Release Document

September 2018

taxworkingroup.govt.nz/key-documents

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;

[2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

SUBMISSION TO TAX WORKING GROUP

ON THE ISSUE OF IMPROVING KIWISAVER TO REDUCE THE BURDEN ON NEW ZEALAND SUPERANNUATION

By

Drew Hoffman

Authorised Financial Adviser

[1]

12 April 2018

SUMMARY OF MAJOR POINTS AND RECOMMENDATIONS

1. The number of people over 65 is increasing rapidly. The ratio of people aged 65 and over as a proportion of people aged 15-64 is projected to more than double by 2068.
2. New Zealand Superannuation will be put under strain because of the increase in the percentage of people in retirement. More of the cost of retirement will need to be placed upon individuals saving for retirement.
3. KiwiSaver has had a good start, but more incentives are needed from both the government and from employers to allow people to save enough to have a comfortable retirement and reduce the burden on New Zealand Superannuation.

I. INTRODUCTION

After 10 years in existence, there are 2.7 million KiwiSaver members and over $40 billion in assets invested in KiwiSaver.[1] These figures exceed all government expectations. The government's surprise says more about its failure to understand the country's need for a retirement vehicle and less about the successful design of the KiwiSaver.

In spite of the large uptake in KiwiSaver, there is trouble on the horizon. According to the Statistics New Zealand, the ratio of people aged 65 and over as a proportion of people aged 15-64 is projected to more than double, from 23% in 2016 to 50% in 2068.[2] The Tax Working Group are well aware of this and you point it out in your Submissions Background Paper.

Another troubling statistic is that the average balance in a KiwiSaver account after 10 years in existence is approximately $15,000.[3] A recent study conducted by Clare Matthews of Massey University indicates that New Zealand Superannuation is not enough for even a bare bones retirement. A couple wanting a comfortable retirement needs a nest egg of nearly $500,000.[4] That figure will only increase as the population demographics strain New Zealand Superannuation.

Of the 2.7 million KiwiSaver members, 1.15 million (42%) of members are not contributing to their KiwiSaver accounts. Over 16% of members are in default schemes.[5] These figures indicate that there is more than a little apathy surrounding KiwiSaver, which does not bode well for many Kiwis' successful retirement.

Inadequate incentives are likely to lead to KiwiSaver members failing to contribute enough to enjoy a successful retirement. Currently, an employee can contribute 3% (after tax) of his or her salary and receive a 3% match from his or her employer, which ends up being less than 3% because it is taxed as well. A KiwiSaver member also receives a maximum of $521.43 (member tax credit) from the government if the member contributes at least $1,042.86.[6]

---

1 Financial Markets Authority, KiwiSaver annual report 2017.

2 Stats NZ, National projections overview, updated 8 March 2017.

3 New Zealand Herald, KiwiSaver hits $40 billion, but balances stay low, May 15, 2017.

4 Stuff, $101,774 in savings needed at 65, just to get by in retirement, July 6, 2017.

5 Financial Markets Authority, KiwiSaver annual report 2017.

6 In prior years, the government matched a member's contribution of up to $1,042.86 dollar for dollar. Up until 2015, the government also provided a $1,000 kick-start when a member first opened a KiwiSaver account. Additionally, the government did not tax the employer match. The government has stripped away with those incentives and benefits.

II. SOLUTIONS

A. TAX INCENTIVES

New Zealand's assistance with employee defined contribution schemes is well below that of other developed countries. The following chart compares New Zealand, Australia, the United Kingdom and the United States. The chart provides the general rules for taxation in the various countries and is not meant to cover all circumstances.

Country	Contributions	Tax on Growth	Distributions
New Zealand	Taxed*	Taxed	No Tax
Australia	Taxed at 15%	Taxed at 15%	No Tax
United Kingdom	No Tax	No Tax	Taxed
United States	No Tax	No Tax	Taxed
United States Roth Option	Taxed	No Tax	No Tax

*New Zealand contributes a maximum of $521.43 if at least $1,042.86 is contributed by the KiwiSaver member.

Once an employee has contributed up to 3% of his or her salary, there is no incentive for him or her to contribute anymore under the KiwiSaver scheme. A contribution rate of 3% for most people is not going to result in a comfortable retirement. With the amount of New Zealand Superannuation likely to diminish because of population demographics, the New Zealand government needs to incentivise Kiwis to save more. As it stands, most people will make the minimum contribution to get the tax credit and the employer match. A persuasive reason to allow a larger tax incentive is that it will cause KiwiSaver members to contribute more and thus will create a disciplined way of contributing to a retirement programme where the money is locked away until the employee reaches age 65.

Any of the tax advantaged options from Australia, the United Kingdom or the United States would be better than New Zealand's current system. Because New Zealand has no tax on the distributions under its current system, for simplicity's sake, the Roth option used in the United States would be an excellent choice. In that system, the employee contribution is taxed upfront just like New Zealand's current system. However, under the Roth method, there is no tax on income and growth and no tax upon distribution from the retirement scheme. Under the Roth method, income and growth on current amounts in KiwiSaver accounts would no longer be taxed and income and growth on additional contributions would not be taxed. I recommend that the limits on contributions be set at $15,000 per annum or 15%, whichever is lower, for employees under age 50. Employees aged 50 and over should have limits of $20,000 or 20%, whichever is lower, to encourage savings for those nearing retirement.

The government actually generated positive revenue off KiwiSaver even taking into account the amount it contributed to the member tax credit. In 2017, after tax employer contributions to KiwiSaver were $1.8 billion. Investment returns in 2017 were $2.7 billion. Tax on those two sums easily exceed the member tax credits of $697 million made by the government.[7] In the future, the amount made by the government on taxation of KiwiSaver will only increase under its current form.

The New Zealand government needs to get serious about encouraging people to prepare adequately for retirement. In order to do that, it needs to give up some of its current revenue, otherwise it will

[7] Financial Markets Authority, KiwiSaver annual report 2017.

have much larger problems on its hands in the future in attempting to fund New Zealand Superannuation. Under this proposal, the government will no longer have to make the member tax credit. If people are better prepared for retirement, the government will not have the larger funding problems for New Zealand Superannuation.

One other point about encouraging retirement savings and taxation needs to be made. It is safe to say that a fair amount of funds invested in KiwiSaver make their way into New Zealand publicly traded companies. The excellent returns in the sharemarket in New Zealand over the last several years were no doubt assisted by the implementation of KiwiSaver. Investment in New Zealand's publicly traded companies assists those companies in that more local investment capital is available and there is less reliance on more expensive foreign capital.

B. Gradually Increase the Employer Match

Currently the employer match is 3%. Initially, the concept was to increase it to 4%. The Global Financial Crisis created challenges for employers and the government left it at 3%. At this point, New Zealand's economy has been doing extremely well. It's time for the employer match to increase. I would suggest that the employer match gradually increase to 5%. However, I would also suggest that employees need to contribute up to 7% to get the 5% match so that employees are incentivised to increase their contributions.[8]

C. Eliminate the Tax on the Income and Growth on the Employer Match

To make a seamless transition and provide incentives for employees to get the highest match, I suggest that the government use the Roth method with respect to employer contributions; i.e. continue to tax the employer match and then allow the employer match to grow (both income and capital appreciation) without being taxed. At the time of distribution from the KiwiSaver account the income and growth on the employer match would not be taxed.[9] Either the government gets serious about providing incentives for retirement or it will create a problem it cannot solve in the future. Kiwis deserve a first class retirement.

D. Eliminate the Provision Allowing Employers to Reduce an Employees Pay to Fund the Match

Section 101B of the KiwiSaver Act 2006 requires an employer to make the KiwiSaver match in addition to the employee's wages. Section 101B (4) essentially allows the employer to ignore that section and reduce the employee's overall compensation by the amount contributed to KiwiSaver. This provision needs to be eliminated. If New Zealanders are going to have a successful retirement, there needs to be cooperation from all three involved—the employee, the employer and the government. Employers in other developed countries have been on board with this for some time. It's time that New Zealand businesses got on board as well.

[8] An easy way to do this is to have a dollar for dollar match by the employer up to 3% of compensation and then 50 cents on the dollar match for the next 2%. For example, an employee who puts in 5% of compensation would get a 4% match from the employer. An employee who contributes 7% of compensation would get a 5% match from the employer.

[9] I would suggest that at retirement age, funds in a KiwiSaver account are required to be distributed. While at that point, there would be no tax on the distribution, once those funds are distributed and invested outside of a KiwiSaver account, the growth and income would be subject to normal taxation rules.

III. Conclusion

KiwiSaver has had a successful start. However, to make it a programme that substantially increases the ability of New Zealanders to have a successful retirement and reduces the problems of an ageing population, tax and employer incentives are needed so that contributions will increase. Over the long term, this will reduce the burden on New Zealand Superannuation, increase the local capital available for New Zealand's publicly traded companies, and reduce reliance on more expensive foreign capital, thereby increasing tax revenues from those companies. The Tax Working Group is welcome to contact me if you have questions.

Drew Hoffman
Authorised Financial Adviser
[1]