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To: Minister of Finance  
cc: Minister of Revenue and Minister for Social Development and Employment

## **AIDE MEMOIRE: IMPLICATIONS OF CHANGING THE TAX MIX FOR MEMBERS OF THE GSF AND NPF, AND POSSIBLE COMPENSATION**

### **Background**

In our earlier briefing on compensation measures (T2020/339) we noted that there were administration issues that need to be considered before making final decisions on what compensation, if any, should be applied to members of the GSF and NPF. This report provides that information and a set of three possible options for Ministers to consider at Monday's sub-group meeting.

### **Type of superannuation schemes**

There are two types of superannuation schemes; defined benefit and defined contribution. Only defined benefit schemes attract automatic adjustments, since payments from defined contribution schemes are limited by the level of accrued contributions. Defined contribution schemes are under pressure at present, because falls in asset values have limited their ability to make extra payments. We do not suggest any compensation for members of these schemes. As asset values recover, it is up to the Trustees of schemes to make decisions on changes.

The majority of annuitants in both GSF and NPF belong to defined benefit schemes. These have legislated automatic adjustments, based on CPI movements, normally from 1 April each year.

### **Options for compensation**

The Government Superannuation Fund Authority, which is in charge of both the GSF and NPF, has advised us that it would be possible to make compensation in the defined benefits schemes, although there are serious administrative issues that would need to be addressed.

The options GSFA put forward were to provide an extra payment from:

- 1) next year, to offset the higher than expected consumer price movements, especially those not picked up by the December quarter CPI movement. That would mean compensation would not start till at least 1 April, and the cost would be a full year rather than a part year.

- 2) 1 October this year until the next automatic annual adjustment. This would be in line with the approach taken with other forms of compensation such as main benefits.

GSFA favour the first option, for administrative simplicity reasons. It would be possible to implement the second option, but would require further work on their systems. The one-off cost of option 1 would be about \$17 million while option 2 would be about half of this. These distinctions are somewhat nebulous, because the Crown is essentially picking up all the costs given the unfunded nature of the defined contribution schemes.

### **Comment**

If the overall objective is horizontal fairness with respect to the treatment of other beneficiaries, then GSF and NPF defined benefit annuitants should have a forward looking adjustment from 1 October. As noted above, this would come at a one-off cost of about \$8.5million. In addition, there would be the annual automatic increases from 2011 due to CPI of approximately \$17 million per annum.

However, it is also possible to make the case that those annuitants aged over 65 are likely to be picking up the benefits of National Superannuation changes, and tax rate changes on other income. Annuitants under 65 would also be picking up the effect of tax changes on other income, including income from work. It is possible to access the GSF defined benefit scheme from age 50, and there is anecdotal evidence that this is not uncommon. And finally, it is unlikely that recipients of private superannuation schemes will have an increase to their payments.

### **Recommendation**

A final decision on this issue will be sought at the Ministerial Sub Group meeting on Monday.

EITHER

*Officials' preferred option:*

Given the potential benefits that GSF and NPF recipients may receive from other parts of the tax package, and potential fairness issues with non-Government (private) pensions **not** bring forward GSF and NPF indexation to 1 October 2010 (payments would still increase by CPI in April 2011).

OR

*Alternative options:*

Bring forward the GSF and NPF indexation to 1 October 2010 (in line with the treatment of other benefit types), at an additional cost of approximately \$8.5 million.

OR

Next time GSF and NPF payments are automatically adjusted increase the payment by 2%, at an additional cost of approximately \$17 million (GSFA preferred alternative).

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