THE TREASURY
Kaitohutohu Kaupapa Rawa

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AIDE MEMOIRE: KIWISAVER EMPLOYER SUPERANNUATION CONTRIBUTION TAX EXEMPTION

This note informs you of the latest changes to the forecasting and policy costing of the Employer Superannuation Contribution Tax (ESCT) exemption. These latest changes to the ESCT costing equally affect both options, but mean that there is some additional fiscal scope to consider the CTU option (option 2) compared with the figures recently provided to you in Treasury report T2008/2179.

This note provides additional information on:

- the cost and benefits of two options for managing the fiscal cost of MTC; and
- the fiscal impact of reducing the ESCT exemption from 4% to 2% as the cost savings yielded by this proposal could be used to partially fund the MTC proposals.

KiwiSaver Member Tax Credit- options to manage fiscal cost

The current member tax credit is $20 per week (about $1040 per year) and is based on contribution level not income level. Employee contributions are currently 4% of income, but if this is less than $1040 per year, employees may pay more than that and still obtain a matching member tax credit (MTC) of up to $1040 per year.

Treasury understands Ministers are considering two options for changes to the MTC:

Option 1: MTC would be $20 per week but capped at 2% of wages (National Party pre-election policy)

At a contribution rate of 2%, employees earning less than $52,000 per year would put in less than $1040 per year. So if the maximum member tax credit is capped at 2%, those employees could not obtain the maximum member tax credit. IRD has also indicated that this proposal requires the introduction of an income test/threshold into the calculation of the member tax credit. This test will be administratively complex to administer.

Option 2: MTC matches contributions up to $20 per week (**CTU proposal)**

Under this option members could make voluntary payments and receive a matching tax credit up to $1040. This option is intended to address the administrative and equity issues associated with option 1 but comes at a significant fiscal cost because of the high concentration of KiwiSaver members who have incomes of $52,000 and below based on June 08 data. There is also a question of whether this option represents value for money. The limited behavioural evidence currently available tends to suggest that low-income groups will continue to rely on NZ Superannuation. This raises wider issues as to whether this proposal is well-targeted and will deliver increased levels of new savings activity.

Employer Superannuation Contribution Tax (ESCT)

The previous ESCT estimates were based on BEFU08 enrolment numbers and have now been updated to included Prefu08 data. There is no difference between option 1 and option 2 in this regard.

The key change between BEFU08 and Prefu08 is that uptake has been increased by about 20% across the board. We will therefore be revising our PAYE (in reality it is a mixture of ESCT, PAYE, other persons tax & company tax) forecasts to reflect as more people join KiwiSaver, more of their income is exempt from tax. This change is shown in Table 2 below in the forecast change effect line.

If the Government confirms its intention to reduce minimum contribution rates from 4% to 2% then the tax forecasts would be increased by the amounts shown in Table 2 under policy cost.

The net effect of these two changes is also shown in table 2, and affects the cost of both options equally. The ESCT changes are likely to generate additional revenue in 09/10 to 12/13 and out-years which could be used to partially offset the costs of the MTC proposals currently under consideration. Previously our policy costs included savings of $93m[1] over 5 years associated with the change in ESCT exemption from 4% to 2%. We have since revised that figure to $231m as shown in the table below. Compared to the figures provided in T2008/2179, the cost of both policy options is now $138m cheaper.

The net cost of the tax package (including tax, independent earner rebate, 2/3 R&D tax credit savings) are shown for the two KiwiSaver options in Table 3.

Revised KiwiSaver Costing

Table 1: KiwiSaver options – savings relative to current policy

($ million) - cost/(saving)	2008/09	2009/10	2010/11	2011/12	2012/13	5-year total
National pre-election - Option 1	(83)	(794)	(972)	(1100)	(1178)	(4127)
CTU proposal – Option 2	(83)	(619)	(777)	(893)	(964)	(3336)

Figures in Table 1 include the effects of changes to the ETC, MTC and the ESCT exemption.

[1] $93m was purely the flow on effect to ESCT revenues whereas the $231m also takes account of other persons tax, PAYE & company tax.

Table 2: KiwiSaver ESCT costs

($ million) - cost/(saving)	2008/09	2009/10	2010/11	2011/12	2012/13	5-year total
BEFU08 Cost ESCT Exemption	86	102	132	166	200	686
Prefu08 Cost ESCT Exemption	103	122	158	199	240	822
ESCT Forecast (new policy) 4% to 2%	103	122	122	122	122	591
Forecast change effect	17	20	26	33	40	136
Policy cost (revised forecast)	**-**	**-**	**(36)**	**(77)**	**(118)**	**(231)**
Net effect	**17**	**20**	**(10)**	**(44)**	**(78)**	**(95)**

Table 3: Net Cost of the Tax Package

($ million) - cost/(saving)	**2008/09**	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**5-year total**
Tax, IER, 2/3 R&D, and KiwiSaver – National pre-election	136	101	(107)	(341)	(354)	**(566)**
Tax, IER, 2/3 R&D, and KiwiSaver - CTU	136	276	88	(134)	(140)	**225**

Summary

There is no difference between options 1 and 2 in terms of ESCT cost, but the additional revenue associated with the revised ESCT costs provides some additional fiscal scope to consider option 2 – the CTU proposal. This is subject to the caveats outlined in the previous IRD/Treasury aide memoire examining the fiscal and policy impacts of options 1 and 2.

In total, the tax package would **cost** $225 million over five years under the CTU proposal, whereas the National pre-election option gives **savings** of $566 million over five years.