The Treasury

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Briefing note

Date: 25 February 2011

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Subject: **KiwiSaver: Member tax credits – Administration processes and computation mechanism**

Background

Member tax credits (MTCs) are paid on the basis of (i) employee contributions and (ii) member voluntary contributions made. The MTCs are matched with contributions up to a statutory maximum (currently $1,042.86).

Contributions based mechanism

At present the entire MTC claims process and the KiwiSaver B2B system is designed on the basis that MTC claims are **not** income-related.

The MTC claim process is driven by providers, who submit claims to Inland Revenue each July based on contributions received by them for the previous year to 30 June. Providers have no knowledge of members' income levels. Inland Revenue then computes the MTC amounts due on the basis of the data returned by providers.

Note - there is no correlation between the MTC 'claim year' and the standard income tax year for most individuals (see diagram A below).

Income-linked mechanism

Linking MTCs to the actual income levels of the member (whether restricting to active income or including passive income) requires a link between the KiwiSaver database and the income tax database; this does not presently exist.

Where a member is required to file a tax return Inland Revenue may not receive the income information until April of the following year. There would be, of necessity, at least a 15-month time lag between the income year and the income 'matched' to the MTC claim year. This could impact Scheme Providers, who currently claim for, and receive, MTC payments shortly after their 30 June year end.

If Inland Revenue were to perform the linking of income data to MTC claims – which appears the only feasible option – then it would require significant modifications to both the tax and the KiwiSaver IT systems.

Other delivery options could include requiring the member themselves to claim MTCs on their tax return. This is an unexplored option, but initial thoughts are that it is still likely to require changes to IT systems, and is likely to increase the numbers who have to file a tax return. It would also be a significant step away from the current 'set and forget' design that is inherent in many KiwiSaver features.

<table>
<tr><th rowspan="2">Mechanism</th><th rowspan="2">Applied to?</th><th colspan="3">Impacts</th></tr>
<tr><th>Scheme Providers (SP)</th><th>Inland Revenue (IR)</th><th>Members</th></tr>
<tr><td rowspan="2">Contributions based (current)

Target MTC rates/amounts to contributions; No link to income received per se but contributions made to provider</td><td>Employees (Salary and Wage earners) only
Employee contributions only</td><td>▪ Would requires some changes in claim processes to separately identify source of contributions, but most providers already have data in system.</td><td rowspan="2">▪ As based entirely on contributions made to provider there is no link between KS database and income tax database.

▪ Change in formula for part year calculations, but otherwise only minor administrative impacts</td><td rowspan="2">▪ Would be affected by whatever MTC change was proposed but not the continued use of this mechanism.</td></tr>
<tr><td>All members
Includes employee and voluntary (e.g. self-employed) contributions</td><td>▪ MTC claim year differs from standard income tax year, so extra MTC claims would not reflect income in a tax year.
▪ Closer to current system; e.g if double MTC rate simply double all MTC claims, if half MTC cap simply half amount claimed.</td></tr>
<tr><td rowspan="2">Link to income
Income data taken from individual tax return or PAYE record

Could include all income received, including return on capital, or just ‘active’ income</td><td>Employees (Salary and Wage earners) only</td><td>▪ As above, although could base solely on approximate data re: salary and wages from PAYE record
▪ Members with Personal Tax Summary - income details delayed.
▪ Delay in claims for some WFFTC & CS customers.</td><td rowspan="2">▪ No relationship between KiwiSaver deductions database and income tax database, as currently MTC not income tested.
▪ Changes to internal IT systems would be extensive, and highly costly.
▪ Part year calculations may be more complex and delayed claimed.
▪ Base figure for self employed income – could be gross, income less expenses or income after losses. Need to apportion over income years.</td><td rowspan="2">▪ Depends on new process; but if IR needs to confirm income levels to pay MTC this may put pressure on Agents to file returns, depending on which income year claim comparison is made to.
▪ If members have to make claim directly, or provide income details to their provider there will be a significant increase in compliance costs for members.
▪ Money not invested for up to one year later.</td></tr>
<tr><td>All members</td><td>▪ SP do not have member’s income details, so IR would need to determine final MTC claim amount or member provide income amount to provider.
▪ MTC claim year differs from standard income tax year. May mean delay in claims – 7 July up to April year following for agents.
▪ Significant changes in claim processes and B2B messages.
▪ SP would not know if member files IR3 could require multiple annual claims</td></tr>
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Diagram A - Difference between the income and KiwiSaver MTC claim year and dates for activities such as Personal Tax Summaries and Income Return filing.